

No. 91-2045-CFX  
Status: GRANTED

Title: R. Gordon Darby, et al., Petitioners  
v.  
Henry G. Cisneros, Secretary of Housing and Urban  
Development, et al.

Docketed:  
June 18, 1992

Court: United States Court of Appeals for  
the Fourth Circuit

Counsel for petitioner: Gordon, Steven D.

Counsel for respondent: Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Jun 18 1992	G	Petition for writ of certiorari filed.
3	Jul 17 1992		Order extending time to file response to petition until August 19, 1992.
4	Aug 19 1992		Brief of respondents Jack Kemp, et al. in opposition filed.
5	Aug 26 1992		DISTRIBUTED. September 28, 1992
6	Sep 17 1992		Record requested.
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8	Oct 15 1992		Record filed.
		*	Certified proceedings from USCA/4, USDC, District of South Carolina (1 box)
9	Nov 2 1992		Petition GRANTED. *****
10	Dec 17 1992		Joint appendix filed.
11	Dec 17 1992		Brief of petitioners R. Darby, et al. filed.
13	Jan 7 1993		Order extending time to file brief of respondent on the merits until January 26, 1993.
14	Jan 26 1993		Brief of respondents filed.
16	Feb 4 1993		CIRCULATED.
17	Feb 26 1993	X	Reply brief of petitioners filed.
15	Mar 3 1993		SET FOR ARGUMENT MONDAY, MARCH 22, 1993. (1ST CASE)
18	Mar 22 1993		ARGUED.

91-2045

No. \_\_\_\_\_

Supreme Court, U.S.

FILED

JUN 18 1992

OFFICE OF THE CLERK

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1991

R. GORDON DARBY; DARBY DEVELOPMENT COMPANY;  
DARBY REALTY COMPANY; DARBY MANAGEMENT COM-  
PANY, INCORPORATED; MD INVESTMENT; PARKBROOK  
ACRES ASSOCIATES; and PARKBROOK DEVELOPERS,

*Petitioners,*

v.

JACK KEMP, SECRETARY OF HOUSING AND URBAN DE-  
VELOPMENT; ARTHUR J. HILL, ASSISTANT SECRETARY  
FOR HOUSING/FHA COMMISSIONER; U.S. DEPARTMENT  
OF HOUSING AND URBAN DEVELOPMENT; and UNITED  
STATES OF AMERICA,

*Respondents.*

**Petition for a Writ of Certiorari to the  
United States Court of Appeals  
for the Fourth Circuit**

**PETITION FOR A WRIT OF CERTIORARI**

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### **QUESTION PRESENTED**

Can a federal appeals court impose an exhaustion requirement as a "rule of judicial administration" notwithstanding Section 10(c) of the Administrative Procedure Act and thereby foreclose judicial review of final adverse agency action, based upon a litigant's failure to pursue a permissive administrative appeal that is not required by statute or agency regulation?

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*Petitioners,*

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\_\_\_\_\_  
**PETITION FOR A WRIT OF CERTIORARI**  
\_\_\_\_\_

Petitioners respectfully pray that a writ of certiorari  
issue to review the judgment and opinion of the United  
States Court of Appeals for the Fourth Circuit, entered  
in the above-entitled proceeding on February 26, 1992.

### OPINIONS BELOW

The opinion of the Court of Appeals for the Fourth Circuit is reported at 957 F.2d 145, and is reprinted in the appendix hereto, p. 1a, *infra*.

The memorandum decision of the United States District Court for the District of South Carolina (Norton, J.) has not been reported. It is reprinted in the appendix hereto, p. 20a, *infra*.

The initial decision and order of the Administrative Law Judge ("ALJ") of the United States Department of Housing and Urban Development ("HUD") has not been reported. It is reprinted in the appendix hereto, p. 33a, *infra*. The "final determination" of HUD debarring petitioners in accordance with the ALJ's initial decision and order likewise has not been reported. It is reprinted in the appendix hereto, p. 91a, *infra*.

### JURISDICTION

Invoking federal jurisdiction under 28 U.S.C. §§ 1331, 1346, and 2201, petitioners brought this action in the District of South Carolina. On October 26, 1990, the district court denied a motion by the respondents to dismiss for failure to exhaust administrative remedies. On April 10, 1991, the district court granted petitioners' motion for summary judgment. (Appendix 8a).

On respondents' appeal, the Fourth Circuit on February 26, 1992, entered a judgment and an opinion reversing the district court's order of October 26, 1990, and directing that petitioners' complaint be dismissed for failure to exhaust administrative remedies. On March 20, 1992, the circuit court denied petitioner's petition for rehearing. (Appendix, p. 93a).

The jurisdiction of this Court to review the judgment of the Fourth Circuit is invoked under 28 U.S.C. § 1254(1).

### STATUTE INVOLVED

Section 10(c) of the Administrative Procedure Act, 5 U.S.C. § 704, entitled "Actions Reviewable," provides in pertinent part that:

Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

### STATEMENT OF THE CASE

HUD initiated administrative sanctions against petitioner Darby on June 19, 1989, by issuing a one-year Limited Denial of Participation ("LDP"). Mr. Darby contested the issuance of this LDP at an administrative conference, following which HUD affirmed the LDP by letter dated July 11, 1989. Mr. Darby then initiated an administrative appeal of the LDP on July 21, 1989.

By notice dated August 23, 1989, HUD's debarring official (the Assistant Secretary for Housing) proposed to debar all petitioners—Mr. Darby and his affiliates (hereafter, collectively, "Mr. Darby")<sup>1</sup>—from participating in all federal procurement and nonprocurement programs for a period of five years, based on the same underlying facts and circumstances that gave rise to the LDP. HUD subsequently filed a formal debarment complaint and Mr. Darby filed an answer. By letter dated November 16, 1989, the debarring official increased the length of the proposed debarments to an indefinite period.

The LDP appeal and the debarment action were consolidated for hearing before a HUD ALJ. A four-day

<sup>1</sup> Pursuant to Supreme Court Rule 29.1, petitioner states that there are no parent companies or subsidiaries of petitioners.

evidentiary hearing was conducted on December 19-22, 1989, in Charleston, South Carolina. Following the hearing, both parties filed briefs and the ALJ took the case under advisement.

On April 13, 1990, ten months after the administrative proceedings had commenced, the ALJ issued a 37-page decision and order upholding the LDP and concluding that Mr. Darby should be debarred for a period of 18 months. The ALJ's decision contained 20 pages of factual findings. Neither party sought discretionary intra-agency review of the ALJ's ruling pursuant to 24 C.F.R. § 24.314(c) which provides that:

The hearing officer's determination shall be final unless . . . the Secretary . . . within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer. . . . Any party may request such a review in writing within 15 days of receipt of the hearing officer's determination.

Significantly, as the Fourth Circuit concluded, this regulation "does not expressly mandate exhaustion of administrative remedies prior to filing suit." (pp. 6a-7a, *infra*). Moreover, it does not provide that the hearing officer's determination (or the administrative sanction) shall be inoperative while Secretarial review is pending. Since neither party petitioned for Secretarial review, the ALJ's decision and order became HUD's final agency action on April 29, 1990.<sup>2</sup>

<sup>2</sup> The HUD Secretary has delegated authority to the Assistant Secretary for Housing to act as the debarring official. 54 Fed. Reg. 4913 (Jan. 31, 1989). Although HUD's regulations, 24 C.F.R. § 24.314(g), require the debarring official to issue a formal "final determination" in a contested case, HUD originally took the position that no such determination was required or would be issued in this case. With the matter in this posture, petitioners filed suit in the district court on May 31, 1990, as discussed below. Three weeks later, and over two months after the ALJ's decision, HUD reversed its position and the Assistant Secretary belatedly issued a "final

Meanwhile, HUD's sanctions had been in effect throughout the pendency of the administrative proceedings and ten months of the eighteen-month debarment had already elapsed.<sup>3</sup> At this point, having diligently but fruitlessly pursued his administrative remedies for almost an entire year, Mr. Darby turned to the district court for redress. He did so only after a full factual record had been created before the agency and after a detailed decision had been rendered by the agency—a decision that was final according to HUD's own regulations.

On May 31, 1990, Mr. Darby filed suit in the United States District Court for the District of South Carolina seeking a declaration that the administrative sanctions violated provisions of the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 701-06, and due process rights guaranteed by the Fifth Amendment. Mr. Darby did not challenge the factual findings made by the HUD ALJ in the complaint.

Respondents moved to dismiss the suit for failure to exhaust administrative remedies on the basis that Mr. Darby had not petitioned for Secretarial review. The district court denied this motion in an order filed on October 26, 1990, concluding that there were

several concerns which militate against a blind application of the [exhaustion] rule under the facts of this case. One concern is that a dismissal would leave the decision of the ALJ wholly unreviewed.

determination" on June 21, 1990, debarring plaintiffs in accordance with the ALJ's decision.

<sup>3</sup> Under HUD's debarment and suspension regulations, 24 C.F.R. Part 24, a LDP is effective immediately upon its issuance. 24 C.F.R. § 24.710(b). Furthermore, evidence that a cause for debarment may exist is itself a cause for suspension. 24 C.F.R. § 24.405(a)(2). Thus, as is standard practice in such cases, Mr. Darby was suspended for the duration of the debarment proceeding against him once HUD issued the notice of proposed debarment.

Another more significant concern is that, under the facts of this case, the available remedy is inadequate. A final concern is that exhaustion of the final administrative remedy would have been futile under the facts of this case.

(p. 28a, *infra*).

The district court proceeded to consider the case on its merits and, on April 10, 1991, granted Mr. Darby's motion for summary judgment. The district court vacated the administrative sanctions based upon its conclusion that "the debarment in this case was not rationally connected to the factual findings of the ALJ, and was further in conflict with the prohibition against imposing debarment for punitive reasons." (p. 17a, *infra*).

On appeal to the Fourth Circuit, respondents challenged only the district court's ruling on exhaustion.<sup>4</sup> Respondents contended that 24 C.F.R. § 24.314(c) (1991) required Mr. Darby to seek Secretarial review as a prerequisite to filing suit in federal court.<sup>5</sup> The circuit court rejected this contention, holding that the regulation "does not expressly mandate exhaustion of administrative remedies prior to filing suit." (pp. 6a-7a, *infra*). Nonetheless, the Fourth Circuit held that, as a "rule of judicial

<sup>4</sup> Although respondents also noted an appeal of the district court's ultimate ruling that the debarment of Mr. Darby was arbitrary and unlawful, they did not pursue that issue in their brief or argument to the circuit court.

<sup>5</sup> It was undisputed that there is no other statutory or regulatory exhaustion provision applicable to this case. HUD's current debarment regulations, 24 C.F.R. Part 24, were promulgated pursuant to Executive Order Number 12549, 51 Fed. Reg. 6370 (1986), which authorized a government-wide system for nonprocurement debarment and suspension, and pursuant to 42 U.S.C. § 3535(d), the housekeeping provision which enables the HUD Secretary to delegate his functions, powers and duties, and to make such rules and regulations as may be necessary to carry out his functions, powers and duties. Neither the statute nor the Executive Order requires exhaustion of an intra-agency appeal or even addresses the issue.

administration," exhaustion is still required "even when a statute does not impose an explicit directive." (p. 4a, *infra*).

Proceeding from this premise, the circuit court ruled as follows:

In the absence of a statutory requirement of exhaustion, the district court properly turned to the judicial doctrine of exhaustion of administrative remedies and to possible avoidance of the rule by application of its exceptions. Our review, however, reveals that the facts do not warrant application of the exceptions. Therefore, the district court improperly denied the Secretary's motion to dismiss. We reverse and remand with instruction to dismiss Darby's complaint for failure to exhaust administrative remedies.

(p. 7a, *infra*). The circuit court made no reference to Section 10(c) of the APA, although that statutory provision was prominently cited in petitioners' brief and during oral argument.

The Fourth Circuit's ruling left Mr. Darby without any recourse since the fifteen-day period in April 1990 during which he could have requested discretionary Secretarial review had long since passed. However, the circuit court was unperturbed by this result.

Yet Darby, by strategic decision or otherwise, allowed the filing period to pass. He cannot now complain that the decision is unreviewable.

(p. 6a, *infra*).

Mr. Darby petitioned for rehearing on the grounds that the court's decision contravened Section 10(c) and was in conflict with the decisions of other circuits which follow that statutory mandate. However, the Fourth Circuit denied this petition without opinion on March 20, 1992.

## REASONS FOR GRANTING THE WRIT

The Fourth Circuit has created a novel and insupportable "rule of judicial administration" that any possible administrative appeal must be exhausted before judicial review may be sought under the APA, even though such exhaustion is not required by relevant statutes or regulations. This ruling amounts to a judicial repeal of Section 10(c) of the APA, in which Congress explicitly provided that a litigant seeking judicial review of a final agency action *need not exhaust* available administrative appeals *unless* such exhaustion is *expressly required by statute or agency rule*.

In addition, the Fourth Circuit's decision conflicts with the opinions of the majority of federal courts that have addressed the issue, and exacerbates the disarray among the circuits about the proper application of the exhaustion doctrine and the impact of Section 10(c). Previously, two other circuits have indicated that, notwithstanding Section 10(c), a federal court has discretion to impose an exhaustion requirement and postpone judicial review. However, no other circuit has gone to the extreme that the Fourth Circuit did in this case, overriding Section 10(c) and depriving a litigant of judicial review in the process. Absent review and reversal by this Court, the Fourth Circuit's decision sets a pernicious precedent that will perpetrate further injustices in innumerable future cases.

Courts should not decline the exercise of jurisdiction under a federal statute pursuant to the exhaustion doctrine unless it is consistent with congressional intent. *Coit Indep. Joint Venture v. FSLIC*, 489 U.S. 561, 580 (1989). Indeed, federal courts "have no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given." *McCarthy v. Madigan*, — U.S. —, 112 S.Ct. 1081, 1087 (1992), citing *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 404 (1821). Accordingly, this Court has recently held, in a decision

issued after the Fourth Circuit's decision in this case, that:

Where Congress specifically mandates, exhaustion is required. But where Congress has not clearly required exhaustion, sound judicial discretion governs. Nevertheless, even in this field of judicial discretion, appropriate deference to Congress' power to prescribe the basic procedural scheme under which a claim may be heard in a federal court requires fashioning of exhaustion principles in a manner consistent with congressional intent and any applicable statutory scheme.

*McCarthy v. Madigan*, — U.S. at —, 112 S.Ct. at 1087 (citations omitted).

### I. THE FOURTH CIRCUIT'S DECISION DECIDES AN IMPORTANT FEDERAL QUESTION IN A WAY THAT PATENTLY VIOLATES THE ADMINISTRATIVE PROCEDURE ACT

In enacting the judicial review provisions of the APA, Congress dealt explicitly with the issue of exhaustion of administrative remedies. It provided in Section 10(c) that:

Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or unless the agency otherwise is inoperative, for an appeal to superior agency authority.

5 U.S.C. § 704. "[T]he primary thrust of § 704 was to codify the exhaustion requirement." *Bowen v. Massachusetts*, 487 U.S. 879, 903 (1988). The clear meaning of this provision is that exhaustion of intra-agency appeals is not a prerequisite to judicial review under the APA except to the extent that other statutes or appropriate agency rules command otherwise. See 4 Kenneth C. Davis, *Administrative Law Treatise* § 26:12, p. 470 (2d ed.

1983); *New England Coalition on Nuclear Pollution v. United States Nuclear Regulatory Comm'n*, 582 F.2d 87, 99 (1st Cir. 1978).

The legislative history of the APA leaves no doubt about this conclusion. While the legislation was pending before Congress, the Department of Justice submitted to both the Senate and House Committees on the Judiciary a detailed analysis of the statute. It summarized Section 10(c) in the following terms:

Section 10(c): This subsection states (subject to the provisions of section 10(a)), the acts which are reviewable under section 10. It is intended to state existing law. *The last sentence makes it clear that the doctrine of exhaustion of administrative remedies with respect to finality of agency action is intended to be applicable only (1) where expressly required by statute (as, for example, is provided in 49 U.S.C. 17(9)), or (2) where the agency's rules require that decisions by subordinate officers must be appealed to superior agency authority before the decision may be regarded as final for purposes of judicial review.*

*Administrative Procedure Act: Legislative History 79th Congress*, 230 (1946) ("APA Leg. Hist.") (emphasis added); see also *Samuel B. Franklin & Co. v. SEC*, 290 F.2d 719, 724 (9th Cir.), cert. denied, 368 U.S. 889 (1961) (discussing this legislative history).

The Senate Judiciary Committee's report on the APA includes the following discussion of Section 10(c):

The last clause, permitting agencies to *require by rule* that an appeal be taken to superior agency authority before judicial review may be sought, is designed to implement the provisions of section 8(a). Pursuant to that subsection an agency may permit an examiner to make the initial decision in a case, which becomes the agency's decision in the absence of an appeal to or review by the agency. If there is

such review or appeal, the examiner's initial decision becomes inoperative until the agency determines the matter. For that reason *this subsection permits an agency also to require by rule that, if any party is not satisfied with the initial decision of a subordinate hearing officer, the party must first appeal to the agency (the decision meanwhile being inoperative) before resorting to the courts. In no case may appeal to "superior agency authority" be required by rule unless the administrative decision meanwhile is inoperative, because otherwise the effect of such a requirement would be to subject the party to the agency action and to repetitious administrative process without recourse. There is a fundamental inconsistency in requiring a person to continue "exhausting" administrative processes after administrative action has become, and while it remains, effective.*

S. Rep. No. 752, 79th Cong., 1st Sess. (1945), reprinted in APA Leg. Hist. at 185, 213 (emphasis added). The House Judiciary Committee report contains a virtually identical description of Section 10(c). H. Rep. No. 1980, 79th Cong., 2d Sess. (1946), reprinted in APA Leg. Hist. at 233, 277.

Following the enactment of the APA, the Department of Justice prepared a manual analyzing the provisions of the Act as a guide to the federal agencies in adjusting their procedures to comport with the law. That manual discussed the import of Section 10(c) in the following terms:

The last clause of section 10(c) permits an agency to require *by rule* that in such cases parties who are dissatisfied with the "initial" decisions of hearing officers must appeal to the agency before seeking judicial review, but only if the agency further provides that the hearing officers' decisions shall be inoperative pending such administrative appeals.

*Attorney General's Manual on the Administrative Procedure Act 104-05* (1947) (emphasis in the original).

Thus, the logic and the command of Section 10(c) are clear and simple. On one hand, it freely permits an agency (by appropriate rule) or Congress (by statute) to require exhaustion of intra-agency appeals with respect to any particular administrative action. Conversely, absent the imposition of such a requirement, it provides a litigant aggrieved by a final agency decision with the right to seek immediate relief in federal court under the APA. The Fourth Circuit ignored the second half of this statutory mandate and divested the district court of jurisdiction in a situation where Congress has explicitly guaranteed litigants such as Mr. Darby judicial recourse from arbitrary and unjust administrative action.<sup>6</sup>

## II. THE FOURTH CIRCUIT'S DECISION IS IN CONFLICT WITH CIRCUIT COURT DECISIONS ON THE SAME MATTER AND APPLICABLE DECISIONS OF THIS COURT

The Fourth Circuit's decision likewise conflicts with the opinions of the majority of federal courts that have addressed the issue presented here. Those courts have recognized that, for purposes of judicial review under the APA, Section 10(c) dispenses with any requirement to exhaust intra-agency appeals unless another statute or an appropriate agency rule commands otherwise. *New England Coalition on Nuclear Pollution v. United States Nuclear Regulatory Comm'n*, 582 F.2d 87, 99 (1st Cir. 1978); *Steere Tank Lines, Inc. v. ICC*, 675 F.2d 763, 766 (5th Cir. 1982) (citing *New England Coalition*); *Gulf Oil Corp. v. United States Dep't of Energy*, 663 F.2d 296, 308 n.73 (D.C. Cir. 1981) (citing *United States v. Consolidated Mines & Smelting Co.*, 445 F.2d 432 (9th

<sup>6</sup> Perhaps the most disquieting aspect of respondents' litigation posture in this case is that HUD easily could have imposed an exhaustion requirement by regulation, in conformance with Section 10(c). The agency having failed to do so, respondents importuned the Fourth Circuit to impose a judicial exhaustion requirement retroactively and in blatant contravention of Section 10(c).

Cir. 1971); *Mount Sinai Hosp. of Greater Miami v. Weinberger*, 376 F. Supp. 1099, 1124-25 (S.D. Fla. 1974), *rev'd on other grounds*, 517 F.2d 329 (5th Cir. 1975), *cert. denied*, 425 U.S. 935 (1976).

Furthermore, the Fourth Circuit's decision is inconsistent with this Court's decision in *ICC v. Brotherhood of Locomotive Engineers*, 482 U.S. 270, 284-85 (1987), which noted that:

[Section 10(c)] has long been construed by this and other courts . . . to relieve parties from the requirement of petitioning for rehearing before seeking judicial review (unless, of course, specifically required to do so by statute—see, e.g., 15 U.S.C. § 717r, 3416(a)). . . .

(emphasis in the original). Section 10(c) equates a petition "for any form of reconsideration" with "an appeal to superior agency authority" insofar as the need for exhaustion is concerned. The only distinction is that Section 10(c) permits an agency to require by rule an appeal to superior agency authority, whereas a petition for reconsideration or rehearing can only be a prerequisite to judicial review if expressly required by statute. Therefore, in the absence of a statutory or regulatory exhaustion requirement, Section 10(c) relieves parties from the obligation to pursue intra-agency appeals just as surely as it relieves them from the need to file petitions for rehearing.

Unfortunately, the Fourth Circuit's disregard of Section 10(c) cannot be dismissed as aberrational. Professor Davis, in his treatise, has decried the repeated occasions on which this statute has been ignored and violated by federal courts, thereby creating needless and detrimental complexity in the application of the exhaustion doctrine. 4 Kenneth C. Davis, *Administrative Law Treatise* § 26:12 (2d ed. 1983). This Court, in *Bowen v. Massachusetts*, 487 U.S. 879, 902 (1988), repeated Professor

Davis' complaint that Section 10(c) "has been almost completely ignored in judicial opinions." Although many judicial violations of Section 10(c) may have been unwitting, some courts have consciously disregarded it and others evidently are uncertain of its import with respect to application of the exhaustion doctrine.

The Ninth Circuit has explicitly asserted that a federal court may impose an exhaustion requirement notwithstanding Section 10(c). *Montgomery v. Rumsfeld*, 572 F.2d 250 (9th Cir. 1978). Ironically, that same court previously had ruled that Section 10(c) resolves the application of the exhaustion doctrine. *United States v. Consolidated Mines & Smelting Co.*, 455 F.2d 432, 440, 451-52 (9th Cir. 1971).<sup>7</sup> However, in *Montgomery v. Rumsfeld*, the Ninth Circuit retreated from its earlier decision and stated:

There is language in *Consolidated Mines*, *supra*, 455 F.2d at 440, arguably suggesting that not only does section 10(c) not require the exhaustion of intra-agency appeals not mandated by statute or regulation, but that the courts are not free to impose such a requirement on their own . . . .

Although this language might be read to preclude judicial insistence on exhaustion of administrative remedies when the statute or appropriate agency rules do not so insist, the courts have not considered themselves so limited.

572 F.2d at 253 n.3.

<sup>7</sup> The *Consolidated Mines* decision garnered widespread scholarly praise for its treatment of the exhaustion issue. See Project, *Federal Administrative Law Developments—1971, 1972* Duke L.J. 115, 298-99 (1972) (*Consolidated Mines* "has finally brought judicial application of the doctrine of exhaustion of administrative remedies into conformity with the mandate of section 10(c)."); 4 Kenneth C. Davis, *Administrative Law Treatise* § 26:12, p. 470 (2d ed. 1983) (describing *Consolidated Mines* as the "outstanding" example of a court discovering and following Section 10(c)).

This reasoning patently contravenes Section 10(c), although the Ninth Circuit's actual holding was less egregious than the Fourth Circuit's ruling in this case. The unexhausted administrative appeal at issue in *Montgomery v. Rumsfeld* evidently was still a live option for the plaintiffs. Furthermore, the Ninth Circuit suggested that the district court could retain jurisdiction of plaintiffs' suit pending the outcome of that administrative appeal. *Id.* at 253-54. Thus, the imposition of an exhaustion requirement merely postponed judicial review of the challenged agency action and did not, as here, operate to deprive the litigant of ultimate recourse to federal court and, indeed, of any remedy whatsoever.

Yet another circuit recently equivocated about the impact of Section 10(c) on judicial discretion to impose an exhaustion requirement. In *Missouri v. Bowen*, 813 F.2d 864 (8th Cir. 1987), the Eighth Circuit stated that, since neither the governing statutes nor regulations required exhaustion, application of the doctrine rested within the sound discretion of the district court. 813 F.2d at 871. The circuit court went on to uphold the district court's ruling that exhaustion was not required on the facts of that case. In a footnote, the Eighth Circuit added that "it appears that section 10(c) of the APA, in conjunction with the Supreme Court's 'flexible' approach to finality, indicate that an intra-agency appeal in this case was not required." 813 F.2d at 870-71 n.15. Thus, while recognizing the relevance of Section 10(c), the Eighth Circuit held that judicial discretion controls the resolution of the exhaustion issue and implied that Section 10(c) might be outweighed by other considerations.

It appears, however, that no other federal court has adopted the extreme position taken by the Fourth Circuit here—that, even in the absence of a statute or agency rule, exhaustion of all available administrative remedies is *always* required as a "rule of judicial admin-

istration" unless some exception to the exhaustion doctrine applies. Not only does this ruling conflict with Section 10(c) and with the decisions of other circuits applying that statute; it amounts to a wholesale overturning of the clear, simple and fair exhaustion provisions established by Congress in the statute.

### III. THE FOURTH CIRCUIT'S RULE OF JUDICIAL ADMINISTRATION CREATES PERNICIOUS EFFECTS THAT CALL FOR EXERCISE OF THIS COURT'S POWER OF SUPERVISION

The Fourth Circuit has manufactured a "rule of judicial administration" that has virulent consequences for all sides. From the perspective of a person who is aggrieved by final adverse agency action, the Fourth Circuit's rule transforms the administrative appeal process into a prolonged gauntlet that must be run before judicial redress can be sought. Every possible administrative appeal must be pursued upon pain of losing the right to judicial review and perhaps forfeiting any recourse whatsoever. The attendant delays and expenditure of resources will cause many persons to give up before they can obtain judicial review and will, at a minimum, delay judicial review and relief for those litigants who do manage to stay the course. The Fourth Circuit's rule does precisely what Congress sought to proscribe by enacting Section 10(c)—it subjects the person to the agency action and to repetitious administrative process without recourse, thereby enshrining the "fundamental inconsistency" of requiring continued "exhaustion" after administrative action has become, and while it remains, effective.

That is not all. From the perspective of government counsel, the novel Fourth Circuit rule is a potent and tempting tactical weapon to wield in APA litigation, which will multiply procedural litigation and divert resources from focus on the merits of agency action. Indeed, it is a virtually ideal "sandbag" with which to

dispose of litigants altogether by raising the exhaustion issue in federal court after the time limit for any administrative appeal has expired. Likewise, from the agency's perspective, it removes all incentive to promulgate clear rules governing administrative appeals and the need for exhaustion; to the contrary, it creates an incentive for murky procedures that confuse parties and that can be selectively invoked to the agency's tactical advantage.

From the perspective of the district courts, this new rule will further complicate the resolution of exhaustion issues. Apart from the conflict with Section 10(c), it transforms the exhaustion doctrine from a matter of sound judicial discretion into a rigid "rule of judicial administration" with which district courts must comply upon pain of reversal. Furthermore, while the rule has a facial simplicity, usually it will be far more difficult to apply than the standards established by Section 10(c). In many cases, it may be unclear or debatable whether there exists an available administrative appeal that was not exhausted. What, for example, is the need to petition for rehearing or reconsideration? And, if the court concludes that an available appeal was not exhausted, then it must wrestle with the complexities of whether an exception to the exhaustion doctrine applies.

Equally deplorable is the confusion and error which the Fourth Circuit's decision is bound to generate among other federal courts in applying the exhaustion doctrine. It is a precedent directly at odds with the express will of Congress as articulated in Section 10(c) of the APA. It is, moreover, a precedent which derogates from the obligation of federal courts to exercise the jurisdiction given them and, in the case of the APA, to protect citizens from unlawful and abusive agency actions.

This Court has stressed repeatedly that congressional intent is of paramount importance to any exhaustion inquiry. Therefore, lower courts *must* require exhaustion where Congress so mandates and *may* require exhaustion

as a matter of sound judicial discretion where Congress has not spoken. *E.g.*, *McCarthy v. Madigan*, — U.S. —, 112 S.Ct. 1081, 1086 (1992). However, there is a corollary that is insufficiently understood and that now requires explicit attention from this Court, namely, that federal courts *may not* require exhaustion where Congress has expressed a contrary intent.

In particular, federal courts are not at liberty to impose exhaustion requirements which conflict with Section 10(c) of the APA. Section 10(c) has been overlooked by federal courts all too often, with this case being the most egregious example but far from the only one. The Fourth Circuit's application of a rule of judicial administration to bar judicial review of illegal agency action imposed against Mr. Darby works a terrible injustice. It is time for this Court to address and underscore the significance of that provision for the guidance of the lower courts and those litigants who appear before them.

### CONCLUSION

For the foregoing reasons, this petition for certiorari should be granted.

Respectfully submitted,

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# **APPENDICES**

APPENDIX A

UNITED STATES COURT OF APPEALS  
FOURTH CIRCUIT

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No. 91-2113

R. GORDON DARBY; DARBY DEVELOPMENT COMPANY;  
DARBY REALTY COMPANY; DARBY MANAGEMENT COM-  
PANY, INCORPORATED; MD INVESTMENT; PARKBROOK  
ACRES ASSOCIATES; PARKBROOK DEVELOPERS,  
*Plaintiffs-Appellees,*

v.

JACK KEMP, Secretary of Housing and Urban Develop-  
ment; C. AUSTIN FITTS, Assistant Secretary for Hous-  
ing/FHA Commissioner; UNITED STATES OF AMERICA,  
*Defendants-Appellants.*

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Argued Oct. 31, 1991

Decided Feb. 26, 1992

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Lori Marie Beranek, Civil Div., U.S. Dept. of Justice,  
Washington, D.C., argued, for defendants-appellants.

Steven D. Gordon, Dunnells, Duvall & Porter, Wash-  
ington, D.C., argued (Stuart M. Gerson, Asst. Atty. Gen.,  
Anthony J. Steinmeyer, Civil Div., U.S. Dept. of Justice,  
Washington, D.C., E. Bart Daniel, U.S. Atty., Michelle  
Z. Ligon, Asst. U.S. Atty., Marvin J. Caughman, Asst.  
U.S. Atty., Columbia, S.C., on brief), for plaintiffs-  
appellees.

Before PHILLIPS and WILKINS, Circuit Judges, and WARD, Senior District Judge for the Middle District of North Carolina, sitting by designation.

## OPINION

### WILKINS, Circuit Judge:

The Secretary of Housing and Urban Development appeals an order of the district court denying his motion to dismiss R. Gordon Darby's claim that the Secretary improperly debarred him from entering into various transactions with all executive branch agencies. The Secretary asserts that Darby's failure to exhaust the available remedies precludes his filing this action in federal court. We agree. Consequently, we reverse and remand.

### I.

In mid-1982, Darby and his real estate development companies (Darby) began to finance, build and develop multi-family housing projects in South Carolina using single-family mortgage insurance programs offered by the United States Department of Housing and Urban Development (HUD). Darby's financing method evaded HUD limitations on minimum investment requirements and the number of mortgages issued to a single borrower. After an investigation, HUD concluded that the financing method violated various regulations and issued a Limited Denial of Participation (LDP) that prohibited Darby from taking part in HUD programs in South Carolina for one year. The Assistant Secretary for Housing and Urban Development proposed to debar Darby indefinitely after HUD learned that Darby used the same financing method to obtain permanent financing for other housing developments.

Pursuant to HUD regulations, Darby challenged the LDP and the debarment before an Administrative Law Judge (ALJ). See 24 C.F.R. § 24.313 (1991). On April

13, 1990, after a four-day hearing, the ALJ issued an order that upheld the LDP but reduced the indefinite debarment to eighteen months. Neither Darby nor the Secretary sought agency review of this decision. On May 31, 1990, Darby brought this action in district court seeking a declaration that the LDP and debarment violated provisions of the Administrative Procedure Act, *see* 5 U.S.C.A. §§ 551-59, 701-06 (West 1977 & Supp.1991), and due process rights guaranteed by the Fifth Amendment, U.S. Const. amend. V, cl. 4.

The district court denied a motion by the Secretary to dismiss for failure to exhaust administrative remedies. The court concluded that the applicable regulation did not contain an explicit exhaustion requirement. Although recognizing that exhaustion is generally required, the court determined that exceptions to the exhaustion rule applied. Specifically, it held that exhaustion would have been futile and that the available administrative remedies would have been insufficient. Further, the court determined that to require exhaustion would have shielded the ALJ's order from scrutiny. The court therefore excused Darby from exhausting his administrative remedies prior to seeking judicial review. The Secretary appeals the denial of the motion to dismiss.

### II.

Relying on *Holcomb v. Colony Bay Coal Co.*, 852 F.2d 792 (4th Cir.1988), the Secretary contends that 24 C.F.R. § 24.314(c) (1991) imposes a mandatory exhaustion requirement. This section provides:

The hearing officer's determination shall be final unless . . . the Secretary . . . within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer. The 30 day period for deciding whether to review a determination may be extended upon written notice of such extension by the Secretary or his designee. *Any party*

may request such a review in writing within 15 days of receipt of the hearing officer's determination.

*Id.* (emphasis added). Darby argues that the district court properly concluded that the regulation does not prescribe a requirement of exhaustion.

In *Holcomb*, this court examined a virtually identical regulation which provided that a party adversely affected by an ALJ's decision "may file with the [Federal Mine Safety and Health Review] Commission a petition for discretionary review within 30 days after issuance of the order or decision." *Holcomb*, 852 F.2d at 795 (quoting 29 C.F.R. § 2700.70(a) (1987)). We held that the claimant was required to exhaust administrative remedies prior to seeking judicial review. We read *Holcomb* as an application of the rule of judicial administration that even when a statute does not impose an explicit directive, exhaustion is still required. It is a "long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Thetford Properties IV Ltd. P'ship v. United States Dep't of Hous. & Urban Dev.*, 907 F.2d 445, 448 (4th Cir. 1990) (quoting *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51, 58 S.Ct. 459, 463, 82 L.Ed.638 (1938)). The exhaustion doctrine allows an agency to exercise its discretion and apply its expertise, ensures autonomy, and avoids premature intervention by the courts. See *McKart v. United States*, 395 U.S. 185, 193-94, 89 S.Ct. 1657, 1662, 23 L.Ed.2d 194 (1969). It also "allow[s] the courts to have [the] benefit of an agency's talents through a fully developed administrative record." *Thetford Properties IV Ltd. P'ship*, 907 F.2d at 448.

### III.

This conclusion, however, does not end our inquiry. The rule of exhaustion is, however, "like most judicial doctrines, subject to numerous exceptions." *McKart*, 395

U.S. at 193, 89 S.Ct. at 1662. These exceptions include futility of administrative review, see *Honig v. Doe*, 484 U.S. 305, 326-27, 108 S.Ct. 592, 605-06, 98 L.Ed.2d 686 (1988), and inadequacy of administrative remedies, see *Coit Indep. Joint Venture v. Federal Savs. and Loan Ins. Corp.*, 489 U.S. 561, 587, 109 S.Ct. 1361, 1375, 103 L.Ed.2d 602 (1989). Further exhaustion may be excused if its application would leave an administrative decision unreviewed. Cf. *McGee v. United States*, 402 U.S. 479, 484, 91 S.Ct. 1565, 1568, 29 L.Ed.2d 47 (1971).

Although the district court applied the exceptions, we conclude that Darby did not meet his burden to come forward with evidence to excuse him from exhausting his administrative remedies. First, Darby maintains that further administrative review would have been futile because the upper echelons of HUD had endorsed debarment for Darby from the onset of the investigation. However, the record offers no indication that HUD had "taken a hard and fast position that [made] an adverse ruling a certainty." *Thetford Properties IV Ltd. P'ship*, 907 F.2d at 450; cf. *Sweet Life v. Dole*, 876 F.2d 402, 409 (5th Cir. 1989) (When the record did not indicate that review would not have been substantive, the court rejected an argument of futility.). To excuse exhaustion based on an "unsupported allegation of futility would allow the futility exception to swallow the exhaustion rule." *Thetford Properties IV Ltd. P'ship*, 907 F.2d at 450.

Second, the district court deemed section 24.314(c) an inadequate administrative remedy because of the latitude given to the Secretary to extend the time limits within which to issue a decision. Pursuant to section 24.314(c), the Secretary has a 30-day period coupled with a provision granting him discretion to extend this period to review the hearing officer's determination. If the Secretary grants review, he must render a decision within 30 days, again subject to his discretion to extend the time period. 24 C.F.R. § 24.314(e) (1991). The district court

determined that the time limits imposed by sections 24.314(c) and 24.314(e) rested between those the Supreme Court held inadequate in *Coit Independence Joint Venture*, 489 U.S. 561, 109 S.Ct. 1361, and those this court held adequate in *Thetford Properties IV Ltd.*, 907 F.2d 445. In *Coit Independence Joint Venture*, the Supreme Court held that the FSLIC process for adjudicating claims was inadequate because the regulations failed to place well-defined time limits on agency actions. This court, in *Thetford Properties IV Ltd.*, determined that HUD regulations providing a 180-day period for notification and approval of plans "demand[ed] prompt processing" and, therefore, survived *Coit Independence Joint Venture*. *Thetford Properties IV Ltd. P'ship*, 907 F.2d at 449. The district court held that "[a]lthough the administrative process available in this case is not as flawed as that in *Coit*, it is also not as prompt and effective as that found to be adequate in *Thetford*." We conclude that these time limitations provide an adequate administrative remedy in the absence of a showing that the Secretary has failed, or will fail, to act within a reasonable period of time. *Cf. Coit Indep. Joint Venture*, 489 U.S. at 586-87, 109 S.Ct. at 1375 (exhaustion excused because regulations established no time limit for review of claims). Moreover, because Darby did not attempt to exhaust his administrative remedies, it is speculative to suggest that the Secretary would have abused his discretion had he been given the opportunity to exercise it.

Third, the district court determined that application of the exhaustion requirement would bar judicial review of the ALJ's decision because the fifteen-day period during which Darby could have requested a review had passed. Yet Darby, by strategic decision or otherwise, allowed the filing period to pass. He cannot now complain that the decision is unreviewable.

We hold that section 24.314(c) does not expressly mandate exhaustion of administrative remedies prior to filing

suit. In the absence of a statutory requirement of exhaustion, the district court properly turned to the judicial doctrine of exhaustion of administrative remedies and to possible avoidance of the rule by application of its exceptions. Our review, however, reveals that the facts do not warrant application of the exceptions. Therefore, the district court improperly denied the Secretary's motion to dismiss. We reverse and remand with instructions to dismiss Darby's complaint for failure to exhaust administrative remedies.

REVERSED AND REMANDED.

## APPENDIX B

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF SOUTH CAROLINA  
CHARLESTON DIVISION

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C.A. #2:90-1184-18

R. GORDON DARBY,  
DARBY DEVELOPMENT COMPANY,  
DARBY REALTY COMPANY,  
DARBY MANAGEMENT COMPANY, INC.,  
MD INVESTMENT,  
PARKBROOK ACRES ASSOCIATES, and  
PARKBROOK DEVELOPERS,

*Plaintiffs,*

vs.

HONORABLE JACK KEMP  
Secretary of U. S. Department  
of Housing and Urban Development  
451 7th Street, S.W.  
Room No. 10000  
Washington, D.C. 20410,

C. AUSTIN FITTS, Assistant  
Secretary for Housing/FHA  
Commissioner  
451 7th Street, S.W.  
Room No. 9100  
Washington, D.C. 20410,

and

THE UNITED STATES OF AMERICA,  
*Defendants.*

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## ORDER

[Filed Apr. 8, 1991—Entered Apr. 10, 1991]

This matter is before the Court on cross summary judgment motions of the parties. Oral argument on the motions was heard on December 18, 1990. After considering the oral arguments, motions, memoranda, and other material of record, this Court finds, for reasons discussed more fully below, that summary judgment in favor of the plaintiffs is granted, such that the April 13, 1990 Order of the Administrative Law Judge is reversed.

## FACTUAL BACKGROUND

Plaintiff Robert Gordon Darby ("Mr. Darby") is a well-respected self-employed real estate developer who conducts business in South Carolina. In 1977, he formed the Darby Development Company, and began developing and managing multi-family rental projects through the company. To obtain financing for his multi-family projects, Mr. Darby consulted Lonnie Garvin, Jr. ("Mr. Garvin"), a mortgage banker from South Carolina.

Mr. Garvin's company, the Mid-South Financing Company, was established in 1976. Shortly after its establishment, Mid-South became a Housing and Urban Development ("HUD") approved mortgagee concentrating in HUD multi-family rental insurance programs. In early 1981, Mr. Garvin originated a financing plan (the "Mid-South Financing Plan") to enable multi-family developments to use the single family mortgage insurance program to finance the construction of rental units on existing lots. Although the following description is somewhat simplified,<sup>1</sup> the Mid-South Financing Plan worked in the following manner. The person seeking financing used

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<sup>1</sup> A more detailed description of the intricate workings of the financing plan can be found in the April 13, 1990 Order of the Administrative Law Judge.

straw purchasers as mortgage insurance applicants. The straw purchasers were actually Mid-South employees. Once the loans were closed, the straw purchasers would then transfer title back to the development company or to a syndicated limited partnership. The purpose for the use of the straw purchasers was to ensure technical compliance with the "Rule of Seven", 24 C.F.R. § 203.42. The "Rule of Seven" is a HUD regulation that makes rental properties ineligible for single family insurance if the mortgagor already has financial interests in seven or more similar rental properties in the same project or subdivision.<sup>2</sup> The "Rule of Seven" is designed to prevent mass default on single family loans.

In mid-1981, after devising the Mid-South Financing Plan, Mr. Garvin contacted the HUD Columbia office to determine whether the application of the "Rule of Seven" would be satisfied by dividing up the units so that any particular borrower would have no more than seven units at the time of the loan closing. At that time, Mr. Garvin learned from HUD employees Henry Granat, Deputy Director for Housing Development, and Robert DesChamps, Chief of the Mortgage Credit Bureau, that the Mid-South Financing Plan would not violate the "Rule of 7". Thereafter, Mid-South prepared applications for firm commitments and Mr. Garvin again met with Mr. DesChamps and Mr. Granat. This meeting occurred in November of 1981. At the meeting, Mr. Garvin more fully outlined the elements of the Mid-South Financing Plan. Mr. DesChamps, at the direction of Mr. Granat and in the presence of Mr. Garvin, called HUD Headquarters in Washington, D.C. and spoke with Ruth Studer, a HUD employee in the Headquarters Single

<sup>2</sup> See 24 C.F.R. § 203.42 (a), which provides that applicants are not entitled to mortgage insurance if, at the time of the application, the property involved was "part of, or adjacent or contiguous to a project, subdivision or group of similar rental properties which involve eight or more dwelling units if the mortgagor or principals have any financial interest in such properties."

Family Division, Mortgage Credit Section. Ms. Studer was the "point person" for dealing with questions in this area. Based upon the description she was given over the telephone, she advised that the HUD requirements would not be violated by the financing plan.<sup>3</sup>

Although various HUD employees in Columbia knew of the financing method, they only slowly became aware of the extent to which it was being used by Mid-South. This was largely due to the lack of a tracking system which could match the volume of applications for units with the locations of these units. At some point in 1983, an on-site visit by HUD representatives resulted in the realization of the extent and location of the rental projects being financed by Mid-South under the single family mortgage insurance program.

Consequently, Mr. Granat asked his employees to review the propriety of their approval of these applications and was assured that everything was in order. However, to double-check, Mr. DesChamps again contacted Ms. Studer on March 30, 1983.<sup>4</sup> At this time Mr. DesChamps explained to Ms. Studer, in greater detail, the actual mechanism of the Mid-South Financing Plan. Ms. Studer again raised no objections to the process.

In the spring of 1983, HUD Columbia office employees brought to the attention of the office head, Franklin H. Corley, Jr., the volume of units being generated by Mid-South. At about the same time, another builder asked permission to use the Mid-South financing method for its

<sup>3</sup> Ms. Studer is now retired, and does not remember this conversation. However, she testified that she received approximately 30 questions relating to the "Rule of Seven" per week and that she would have said it would be consistent with HUD rules for an individual who had obtained FHA loans on seven units to sell or transfer the properties and come back for seven more as long as there was no continuing financial interest held by the seller.

<sup>4</sup> Ms. Studer has no independent recollection of this conversation either.

properties. Mr. Corley orally advised the builder that he could use the Mid-South program because HUD Columbia had permission from Washington to use this type of plan. Shortly thereafter, the builder informed Mr. Corley that his attorney had advised him not to participate in such a financing arrangement because it was a violation of the multi-family rules and regulations.

Mr. Corley then asked his staff to prepare a memorandum summarizing the Mid-South Financing Plan. This memorandum was sent to Phillip Abrams, Acting Assistant Secretary for Housing/FHA Commissioner. The memorandum described the financing agreement as a proposal and did not make clear or in any way allude to the fact that this proposed agreement had in fact been used on over a thousand occasions.<sup>5</sup>

Mr. Abrams' reply, dated September 23, 1983, stated that the proposal would be unacceptable. The reply further noted that the plan was a vehicle to circumvent the regulations limiting the number of closely located rental units in which the same mortgagor may have a financial interest (the "Rule of Seven").

Thereafter, Mr. Darby's loans went into default, despite what the ALJ termed as "Herculean efforts" on the part of Mr. Darby to resolve the problems and save the projects from financial downfall. In fact, due to circumstances beyond the control of Mr. Darby and Mr. Garvin, virtually all of the mortgage loans obtained through the Mid-South Financing Plan, including Mr. Darby's loans, went into default and HUD ultimately was required to pay substantial insurance on the defaulted loans. Naturally, this led to an investigation of the Mid-South Financing Plan.

<sup>5</sup> It is significant to note however, that of this large number of transactions, only a small percentage were attributable to Mr. Darby's company. In actuality, use of the plan by Mr. Darby's company was minor, and Mr. Darby was not a major participant in the overall scheme.

A HUD audit of the loan transactions was initiated and conducted in the fall of 1986 to discover if there had been any wrongdoing. That audit report concluded that there was no wrongdoing on the part of either Mr. Garvin or Mr. Darby and that neither the HUD Columbia Office nor HUD Headquarters had been misled in any way. Additionally, the United States Attorney declined to pursue a criminal prosecution because the evidence did not support an intent on the part of Mr. Darby or Mr. Garvin to commit a crime.

Inexplicably, on June 19, 1989, HUD, through the manager of its Columbia, South Carolina office, issued plaintiffs a notice of limited denial of participation ("LDP") for a period of one year.<sup>6</sup> On July 21, 1989, plaintiffs filed an appeal from the issuance of the LDP.

On August 23, 1989, HUD's Assistant Secretary notified the plaintiffs of a proposed debarment. On August 28, 1989, the Assistant Secretary for Housing filed a formal complaint requesting debarment for an indefinite period. The plaintiffs appealed from the proposed debarment.

The appeal from the LDP was consolidated with the appeal from the proposed debarment and an extensive hearing was held in Charleston, South Carolina, from December 19 to December 22, 1989. On April 13, 1990, the ALJ issued his order in which he found that good cause existed to debar Mr. Darby and his affiliates for a period of 18 months, beginning on June 19, 1989, the date the LDP was imposed.<sup>7</sup> The debarment was effective throughout all agencies in the executive branch and

<sup>6</sup> The basis for the issuance of the LDP and subsequent debarment are discussed more fully below. See "Factual Background."

<sup>7</sup> Notably, this measure of punishment far exceeded that which was given to these employees of HUD who also had a role in the downfall of the single family program as a result of their erroneous approval of the Garvin program.

prevented plaintiffs from providing services as a contractor to those agencies and from participating in any federal nonprocurement programs. The ALJ also found adequate evidence to uphold the issuance of the LDP. The LDP expired on June 19, 1990. The debarment expired on December 20, 1990.<sup>8</sup>

On May 31, 1990 plaintiffs filed a complaint for declaratory and injunctive relief from the Order of the ALJ. Also on May 31, 1990, plaintiffs filed a motion for a preliminary injunction. The motion for a preliminary injunction sought an order restraining defendants from taking further action to implement the debarment until final adjudication of the complaint for declaratory and injunctive relief. This motion was opposed by the defendants.

On July 7, 1990, defendants filed a motion to dismiss the plaintiffs' complaint for declaratory and injunctive relief. The basis of this motion to dismiss was defendants' assertion that the plaintiffs failed to exhaust their administrative remedies with HUD prior to proceeding on the complaint for declaratory and injunctive relief.

After hearing oral argument and reviewing the briefs, record of the ALJ, and other exhibits, this Court issued an Order dated October 26, 1990, in which it denied both the plaintiffs' Motion for a Preliminary Injunction and the defendants' Motion to Dismiss.

On December 18, 1990, oral argument on the summary judgment motions filed by both parties was heard. Both parties agreed to submit this matter for adjudication in the summary judgment form, relying on the record presently before the Court.

<sup>8</sup> Although the debarment has expired, this Court conducts its review because the "prospect of a lingering stigma or other adverse impact appears to keep this case vital." See *Caiola v. Carroll*, 851 F.2d 395, 401 (D.C.Cir. 1988).

## SCOPE OF REVIEW

Section 706(2) of Title 5 of the United States Code provides that a court sitting in review of an agency determination shall

hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(E) unsupported by substantial evidence.

The distinction between the arbitrary and capricious standard, and the substantial evidence standard "has been described as 'largely semantic.'" *Caiola v. Carroll*, 351 F.2d 395, 398 (D.C. Cir. 1988), citing *Data Processing Serv. Orgs., Inc. v. Board of Governors of the Fed. Reserve Sys.*, 745 F.2d 677, 683-84 (D.C.Cir. 1984). As a practical matter, under either standard, the question is whether there is a rational connection between the facts found and the choice made. *Bowman Transportation v. Arkansas-Best Freight*, 419 U.S. 281, 285 (1974); *Bowman Truck Lines v. U.S.*, 371 U.S. 156 (1962); *Caiola* at 398. Although this standard of review may be a narrow one, in employing the standard, "a court does not rubber stamp the action of the agency." *Port of Jacksonville Maritime Ad Hoc Committee, Inc. v. U.S. Coast Guard*, 788 F.2d 705, 708 (11th Cir. 1986).

While this Court must give the appropriate level of deference to agency factfinding in reviewing an administrative adjudication, it determines *de novo* any questions of law. *First National Bank in Sioux Falls v. National Bank of South Dakota*, 667 F.2d 708, 711 (8th Cir. 1981). Whether an agency properly evaluated the evidence under the governing legal standard is an issue of law receiving plenary review. *Brooms v. U.S. Dept. of Labor*, 870 F.2d 95, 99 (3d Cir. 1989).

A court is always hesitant to reverse an agency decision, especially given the deferential standard of review applicable in such cases. However, in an appropriate case such as this, where this Court is unable to ascertain a rational connection between the facts established and the choice made, and where such irrationality leads to a conclusion that a sanction improper under the law was imposed, it feels compelled to reverse the decision of the ALJ.

### DISCUSSION

The appropriate starting point for this Court's review is a recap of the ALJ's reasons for imposing debarment. It is upon examination of these reasons that it becomes apparent that there was simply no rational connection between the factual findings and the sanction chosen.

As noted in the factual findings above, this case arose out of a HUD related program in which Mr. Darby, through his company, was a participant. The ALJ first found that Mr. Darby "demonstrated a lack of forthrightness in his dealings with the government" and that "the Department demonstrated by preponderant evidence that [Mr. Darby] [lacked] present responsibility. (ALJ Order, p. 30). Additionally, the ALJ found that "debarment [would] serve to deter both [Mr. Darby] and others from taking similar actions." (ALJ Order, p. 30).

In assessing Mr. Darby's conduct, the ALJ then found "no evidence of any intent to deceive the Department," and that Mr. Darby "did not defraud the government." (ALJ Order, p. 36). Immediately after making these findings, the ALJ recognized that a debarment of three years would "serve no legitimate purpose and would be punitive." (ALJ Order, p. 36).

The ALJ went on to conclude that Mr. Darby "genuinely cooperated with HUD to work out his financial dilemma and avoid foreclosure," and that "his efforts in this regard were herculean and beyond reproach." (ALJ

Order, p. 36). The ALJ recognized Mr. Darby's "reputation for truth and veracity among reputable lenders in the community and of his exemplary performance as a builder and manager of housing projects." Despite all of this, the ALJ inconceivably concluded that "a debarment for a meaningful period [was] necessary to deter [Mr. Darby] and others from acting similarly in the future." (ALJ Order, p. 36). In conclusion, the ALJ determined that "[a] debarment of some length is warranted to impress upon Respondent that he must act prudently when dealing with the government and to send a message to those who deal with the government that they, too, must act prudently in similar circumstances." After setting forth these reasons, the ALJ in his "Conclusion and Order" factored in the public interest stating that "[u]pon consideration of the public interest, and the entire record in this matter, I conclude that good cause exists to debar. . . ." (ALJ Order, p. 37).

Although this Court has read and reread the ALJ's order, the nagging inconsistencies in these factual findings have forced upon it one conclusion—that in the final analysis, the debarment in this case was not rationally connected to the factual findings of the ALJ, and was further in conflict with the prohibition against imposing debarment for punitive reasons. The lack of a rational connection contributes significantly to this Court's determination that the overall effect was punitive in nature. As explained below, this type of punitive motive is impermissible in a debarment scheme.

HUD's authority to debar or otherwise sanction program participants derives from and is governed by its debarment regulations, set forth at 24 C.F.R. § 24.100 *et seq.* "The existence of a cause for debarment does not necessarily require that the person be debarred; the seriousness of the person's acts or omissions and any mitigating factors shall be considered in making any debarment decisions." 24 C.F.R. § 24.300. The debarment regulations explicitly provide that "[d]ebarment and suspension

are serious actions which shall be used only in the public interest and for the Federal Government's protection *and not for purposes of punishment*. 24 C.F.R. § 24.115(b) (emphasis added).

In this case, the intent of the ALJ was clearly to send a message and to provide a deterrent. Although some deterrent effect is a permissible and expected side effect of a debarment, where that effect is the sole desired impact, it calls into question the propriety of such an action. This conclusion is supported by the recent decision of the Supreme Court in *United States v. Halper*, 109 S.Ct. 1892 (1989). Although *Halper* may not be directly on point, it certainly provides useful precedent to this Court in its attempt to ascertain the propriety of the ALJ's actions. In *Halper*, the Court held that

the determination whether a given civil sanction constitutes punishment in the relevant sense requires a particularized assessment of the penalty imposed and the purposes that the penalty may fairly be said to serve. Simply put, a civil as well as a criminal sanction constitutes punishment when that sanction as applied in the individual case serves the goals of punishment. 109 S.Ct. at 1898.

Admittedly, the fact "[t]hat a measure, such as debarment, may incidentally punish while it deters . . . does not transform it into a purely punitive sanction." *Janik Paving & Const., Inc. v. Brock*, 828 F.2d 84, 91 (2d Cir. 1987). However,

a civil sanction that cannot fairly be said solely to serve a remedial purpose, but rather can be explained only as serving either retributive or deterrent purposes, is punishment. . . .

*Halper* at 1902.

This Court recognizes the premise espoused in *Janik*—that punishment is an unavoidable side effect of debarment. In this case however, this Court is called upon to

determine where the line is to be drawn between a debarment which serves the acceptable purposes of the debarment scheme, and that which is imposed primarily for the purposes of punishment. In its opinion, imposition of debarment in this case encroached too heavily on the punitive side of the line, and for those reasons was an abuse of discretion and not in accordance with the law.

This conclusion is supported by that reached in a similar decision, *Sellers v. Kemp*, 749 F. Supp. 1001 (W.D. Mo. 1990). The *Sellers* decision also involved a HUD debarment. In *Sellers*, the court criticized the Secretary, whose decision to impose debarment for a lengthy period of time was based on her decision to "send a message." The court held that the Secretary's language indicated that she wanted to make an "example" out of the debarred plaintiffs rather than "fitting an appropriate period of debarment to the actual conduct at issue." *Sellers* at 1009. While the facts of this case are not as egregious as those in *Sellers*, the holding of *Sellers* is nonetheless applicable. The bottom line purpose of the debarment in this case was to send a message of deterrence and to make an example out of the plaintiffs. This Court cannot divine the ALJ's rationale for seeking to impose such a sanction; however, after thoroughly reading and analyzing the Order, this Court inescapably concludes that its overall effect, indeed its primary accomplishment, whether intentional or incidental, is punishment. This is clearly impermissible, and warrants reversal of the ALJ's Order.

Because the Court reverses the ALJ's Order on this basis, it need not address the remaining issues presented by the plaintiffs.

IT IS SO ORDERED.

/s/ David C. Norton  
DAVID C. NORTON  
United States District Judge

April 8, 1991

## APPENDIX C

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF SOUTH CAROLINA  
CHARLESTON DIVISION

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C.A. #2:90-1184-18

R. GORDON DARBY,  
DARBY DEVELOPMENT COMPANY,  
DARBY REALTY COMPANY,  
DARBY MANAGEMENT COMPANY, INC.  
MD INVESTMENT,  
PARKBROOK ACRES ASSOCIATES, and  
PARKBROOK DEVELOPERS,  
*Plaintiffs,*

vs.

HONORABLE JACK KEMP  
Secretary of U. S. Department  
of Housing and Urban Development  
451 7th Street, S.W.  
Room No. 10000  
Washington, D.C. 20410,

C. AUSTIN FITTS, Assistant  
Secretary for Housing/FHA  
Commissioner  
451 7th Street, S.W.  
Room No. 9100  
Washington, D.C. 20410,

and

THE UNITED STATES OF AMERICA,  
*Defendants.*

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## ORDER

[Filed Oct. 26, 1990—Entered Oct. 29, 1990]

This matter is before the Court on the defendants' motion to dismiss and the plaintiffs' motion and amended motion for a preliminary injunction.<sup>1</sup> For reasons discussed more fully below, both the motion to dismiss and the motion for a preliminary injunction are denied.

## FACTUAL BACKGROUND

Plaintiff Robert Gordon Darby ("Mr. Darby") is a well-respected self-employed real estate developer who conducts business in South Carolina. In 1977, he formed the Darby Development Company, and began developing and managing multi-family rental projects through the company. To obtain financing for his multi-family projects, Mr. Darby consulted Lonnie Garvin, Jr. ("Mr. Garvin"), a mortgage banker from South Carolina.

Mr. Garvin's company, the Mid-South Financing Company, was established in 1976. Shortly after its establishment, Mid-South became a Housing and Urban Development ("HUD") approved mortgagee concentrating in HUD multi-family rental insurance programs. In early 1981, Mr. Garvin originated a financing plan (the "Mid-South Financing Plan") to enable multi-family developments to use the single family mortgage insurance program to finance the construction of rental units on existing lots. Although the following description is somewhat

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<sup>1</sup> After oral argument, plaintiffs filed a motion to amend the previous motion for a preliminary injunction. This motion was based on a September 21, 1990 letter from HUD to plaintiffs setting forth additional consequences of the sanctions against plaintiffs. Subsequently the action taken in the September 21, 1990 letter was reversed in letters of October 1, 1990 and October 2, 1990. Therefore, it appears to this Court that the motion to amend should be denied as the issue has now become moot.

Along with their motion to amend, the plaintiffs also filed a motion for summary judgment. That motion is not being considered at this time.

simplified<sup>2</sup>, the Mid-South Financing Plan worked as follows: The person seeking financing used straw purchasers as mortgage insurance applicants. The straw purchasers were actually Mid-South employees. Once loans were closed, the straw purchasers would then transfer title back to the development company or to a syndicated limited partnership. The purpose for the use of the straw purchasers was to ensure technical compliance with the "Rule of Seven", 24 C.F.R. § 203.42. The "Rule of Seven" is a HUD regulation that makes rental properties ineligible for single family insurance if the mortgagor already has financial interests in seven or more similar rental properties in the same project or subdivision.<sup>3</sup> The "Rule of Seven" is designed to prevent mass default on single family loans.

In mid-1981, after devising the Mid-South Financing Plan, Mr. Garvin contacted the HUD Columbia office to determine whether the application of the "Rule of Seven" would be satisfied by dividing up the units so that any particular borrower would have no more than seven units at the time of the loan closing. At that time, Mr. Garvin learned from HUD employees Henry Granat, Deputy Director for Housing Development, and Robert DesChamps, Chief of the Mortgage Credit Bureau, that the Mid-South Financing Plan would not violate the "Rule of 7". Thereafter, Mid-South prepared applications for firm commitments and Mr. Garvin again met with Mr. DesChamps and Mr. Granat. This meeting occurred in November of 1981. At the meeting, Mr.

<sup>2</sup> A more detailed description of the intricate workings of the financing plan can be found in the April 13, 1990 Order of the Administrative Law Judge.

<sup>3</sup> See 24 C.F.R. § 203.42 (a), which provides that applicants are not entitled to mortgage insurance if, at the time of the application, the property involved was "part of, or adjacent or contiguous to a project, subdivision or group of similar rental properties which involve eight or more dwelling units if the mortgagor or principals have any financial interest in such properties."

Garvin more fully outlined the elements of the Mid-South Financing Plan. Mr. DesChamps, at the direction of Mr. Granat and in the presence of Mr. Garvin, called HUD Headquarters in Washington, D. C. and spoke with Ruth Studer, a HUD employee in the Headquarters Single Family Division, Mortgage Credit Section. Ms. Studer was the "point person" for dealing with questions in this area. Based upon the description she was given over the telephone, she advised that the HUD requirements would not be violated.<sup>4</sup>

Although various HUD employees in Columbia knew of the financing method, they only slowly became aware of the extent to which it was being used by Mid-South. This was largely due to the lack of a tracking system which could match the volume of applications for units with the locations of these units. At some point in 1983, an onsite visit by HUD representatives resulted in a realization of the extent and location of the rental projects being financed by Mid-South under the single family mortgage insurance program.

Consequently, Mr. Granat asked his employees to review the propriety of their approval of these applications and was assured that everything was in order. How to double-check, Mr. DesChamps again contacted Studer on March 30, 1983.<sup>5</sup> At this time Mr. DesChamps explained to Ms. Studer, in greater detail, the actual mechanism of the Mid-South Financing Plan. Ms. Studer again raised no objections to the process.

<sup>4</sup> Ms. Studer is now retired, and does not remember this conversation. However, she testified that she received approximately 30 questions relating to the "Rule of Seven" per week and that she would have said it would be consistent with HUD rules for an individual who had obtained FHA loans on seven units to sell or transfer the properties and come back for seven more as long as there was no continuing financial interest held by the seller.

<sup>5</sup> Ms. Studer has no independent recollection of this conversation either.

In the spring of 1983, HUD Columbia office employees brought to the attention of the office head, Franklin H. Corley, Jr., the volume of units being generated by Mid-South. At about the same time, another builder asked permission to use the Mid-South financing method for its properties. Mr. Corley orally advised the builder that he could use the Mid-South program because HUD Columbia had permission from Washington to use this type of plan. Shortly thereafter, the builder informed Mr. Corley that his attorney had advised him not to participate in such a financing arrangement because it was a violation of the multi-family rules and regulations.

Mr. Corley then asked his staff to prepare a memorandum summarizing the Mid-South Financing Plan. This memorandum was sent to Phillip Abrams, Acting Assistant Secretary for Housing/FHA Commissioner. The memorandum described the financing agreement as a proposal and did not make clear or in any way allude to the fact that this proposed agreement had in fact been used on over a thousand occasions.

Mr. Abrams' reply, dated September 23, 1983, stated that the proposal would be unacceptable. The reply further noted that the plan was a vehicle to circumvent the regulations limiting the number of closely located rental units in which the same mortgagor may have a financial interest (the "Rule of Seven").

Thereafter, Mr. Darby's loans went into default, despite what the ALJ termed as "Herculean efforts" on the part of Mr. Darby to resolve the problems and save the projects from financial downfall. In fact, due to circumstances beyond the control of Mr. Darby and Mr. Garvin, virtually all of the mortgage loans obtained through the Mid-South Financing Plan, including Mr. Darby's loans, went into default and HUD ultimately was required to pay substantial insurance on the defaulted loans. Naturally, this led to an investigation of the Mid-South Financing Plan.

A HUD audit of the loan transactions was initiated and conducted in the fall of 1986 to discover if there had been any wrongdoing. That audit report concluded that there was no wrongdoing on the part of either Mr. Garvin or Mr. Darby and that neither the HUD Columbia Office nor HUD Headquarters had been misled in any way. Additionally, the United States Attorney declined to pursue a criminal prosecution because the evidence did not support an intent on the part of Mr. Darby or Mr. Garvin to commit a crime.

Inexplicably, on June 19, 1989, HUD, through the manager of its Columbia, South Carolina office, issued plaintiffs a notice of limited denial of participation ("LDP") for a period of one year.<sup>6</sup> On July 21, 1989, plaintiffs filed an appeal from the issuance of the LDP.

On August 23, 1989, HUD's Assistant Secretary notified the plaintiffs of a proposed debarment. On August 28, 1989, the Assistant Secretary for Housing filed a formal complaint requesting debarment. The plaintiffs appealed from the proposed debarment.

The appeal from the LDP was consolidated with the appeal from the proposed debarment and an extensive hearing was held in Charleston, South Carolina, from December 19 to December 22, 1989. On April 13, 1990, the ALJ issued his order in which he found that good cause existed to debar Mr. Darby and his affiliates for a period of 18 months, beginning on June 19, 1989, the date the LDP was imposed. The debarment is effective throughout all agencies in the executive branch and prevents plaintiffs from providing services as a contractor to those agencies and from participating in any federal nonprocurement programs. The ALJ also found adequate evidence to uphold the issuance of the LDP. The LDP expired on June 19, 1990. The debarment will expire on December 20, 1990.

<sup>6</sup> The basis for the issuance of the LDP and subsequent debarment are discussed more fully below. See "Factual Background."

On May 31, 1990 plaintiffs filed a complaint for declaratory and injunctive relief from the Order of the ALJ. Also on May 31, 1990, plaintiffs filed a motion for a preliminary injunction. The motion for a preliminary injunction seeks an order restraining defendants from taking further action to implement the debarment until final adjudication of the complaint for declaratory and injunctive relief. This motion was opposed by the defendants.

On July 7, 1990, defendants filed a motion to dismiss the plaintiffs' complaint for declaratory and injunctive relief. The basis of this motion to dismiss is that the plaintiffs failed to exhaust their administrative remedies with HUD prior to proceeding on the complaint for declaratory and injunctive relief.

After hearing oral argument and reviewing the briefs, record of the ALJ, and other exhibits, this Court finds, for reasons discussed more fully below, that: (1) the defendants' motion to dismiss should be denied; and (2) the plaintiffs' motion for a preliminary injunction should also be denied.

## DISCUSSION

### A. DEFENDANTS' MOTION TO DISMISS

Defendants filed a motion to dismiss based on plaintiffs' failure to exhaust their administrative remedies with HUD as prescribed by 24 C.F.R. § 24.314. Section 24.314(c) provides that:

[t]he hearing officer's determination shall be final unless, pursuant to 24 C.F.R. Part 26, the Secretary or the Secretary's Designee, within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer. The 30 day period for deciding whether to review a determination may be extended upon written notice of such extension by the Secretary or his designee. Any party may request such a review in writing within

15 days of receipt of the hearing officer's determination.

If the Secretary determines within his discretion to review the determination of the ALJ, then section 24.314 (e) further provides that:

[s]uch a review or determination shall be issued within 30 days of the decision to grant review, unless written notice is given by the Secretary or designee extending the period for making such a determination.

Defendants contend that because plaintiffs failed to petition the Secretary for review within fifteen days of the ALJ's decision, as provided for in section 24.314(c), plaintiffs are now precluded from petitioning this Court for judicial review.

"The basic purpose of the exhaustion doctrine is to allow an Administrative Agency to perform functions within its special competence—to make a factual record, to apply its expertise, and to correct its own errors so as to moot judicial controversies." *Parisi v. Davidson*, 405 U.S. 34, 37 (1972). In determining whether the exhaustion doctrine should be applied in a particular case, this Court must balance the competing interests at stake—the policy served by the doctrine on the one hand versus its impact on the particular litigants on the other hand. *United States Ex Rel Brooks v. Clifford*, 412 F.2d 1137 (1969). The exhaustion requirement is not to be applied 'blindly in every case'. *McGee v. United States*, 402 U.S. 479, 484-85 (1971), citing *McKart v. United States*, 395 U.S. 185, 201 (1969).

Section 24.314 of the CFR does not explicitly provide a provision establishing that a person who fails to exhaust administrative remedies available thereunder is precluded from obtaining judicial review. Further, 5 U.S.C.A. §§ 701-706, which pertains to "Judicial Review" of an

agency decision, contains no such express mandatory provision.

Of course, even absent an express statutory provision, this Court is nonetheless guided by the general rule at common law that administrative remedies must be exhausted prior to proceeding in court. As noted above, however, this rule is not to be applied blindly in every case. This Court notes several concerns which militate against a blind application of the rule under the facts of this case. One concern is that a dismissal would leave the decision of the ALJ wholly unreviewed.

Another more significant concern is that, under the facts of this case, the available remedy is inadequate. A final concern is that exhaustion of the final administrative remedy would have been futile under the facts of this case.

In assessing the adequacy of the administrative scheme the Court notes the following: Under the administrative scheme available in this case the Secretary is entitled to decide whether to review an administrative decision. In making this discretionary call, the Secretary is initially allowed thirty days. However, should the Secretary not make the decision within the allotted time, he has the latitude to further extend the period within which he will issue his determination as to whether or not he will review the decision of the ALJ. Further, after this protracted period, the Secretary is entitled to an additional thirty day to render a decision as to whether to uphold or vacate the decision of the ALJ. Again, however, the Secretary can, of his own accord, extend that time.

The defendants cite for the Court's review the case of *Thetford Properties v. Dept. of Hous. & Urban Dev.*, 907 F.2d 445 (4th Cir. 1990). *Thetford* is distinguishable from the facts of this case. In *Thetford*, the plaintiff never filed a "plan of action" with HUD as required by the regulations, but instead sought immediate relief in

the federal court. There was no hearing and no record made at the administrative stage. The court, in holding that the plaintiff had failed to exhaust his administrative remedies, noted the importance of compliance with such remedies in that case because compliance could well have resulted in an elimination of the need for the plaintiff to resort to the federal forum.

In *Thetford*, the court contrasted that factual situation with the one presented in *Coit Independence Joint Venture v. Federal Savings and Loan Ins. Corp.*, — U.S. —, 109 S.Ct. 1361, — L.Ed.2d — (1989). In *Coit*, the Court held the FSLIC's process for adjudicating claims to be inadequate because it imposed no well-defined time limits for agency action. In *Thetford*, however, the pertinent HUD regulations "demand[ed] prompt processing." 907 F.2d at 449.

The facts of this case lie somewhere between the facts in *Thetford* and those in *Coit*. Although the administrative process available in this case is not as flawed as that in *Coit*, it is also not as prompt and effective as that found to be adequate in *Thetford*. The inadequacy here lies in the latitude given the Secretary in determining the time limits within which to issue a decision.

Based on the concerns present in this case regarding the adequacy of the administrative remedy, as well as the probability that resort to that remedy would have been futile, this Court finds that the defendants' motion to dismiss should be denied.

#### B. PLAINTIFF'S MOTION FOR A PRELIMINARY INJUNCTION

The standard for securing a preliminary injunction is well established. There are four factors which enter into a determination of whether to grant or withhold interim relief: (a) the plaintiff's likelihood of success on the merits in the underlying dispute between the parties; (b) whether the plaintiff will suffer irreparable injury

if interim relief is denied; (c) the injury to the defendant if an injunction is issued; and (d) the public interest. *North Carolina State Ports Authority v. Dart Container Line Company*, 592 F.2d 749, 750 (4th Cir. 1979). Further, there is a correlation between the likelihood of the plaintiff's success on the merits and the probability of irreparable injury to him. If the likelihood of success is great, the need for showing the probability of irreparable harm is less. *Id.*

In assessing the likelihood of success on the merits, this Court must keep in mind the standard of review ultimately applicable in the underlying action. The role of this Court, when called upon to review an administrative decision to debar a contractor, is to determine whether that decision was arbitrary, capricious, or an abuse of discretion not in accordance with the law. *Camp v. Pitts*, 411 U.S. 138 (1973); *Citizens to Protect Overton Park v. Volpe*, 401 U.S. 402 (1971). In applying the arbitrary and capricious standard, the scope of judicial review is limited to whether the agency action was "rational, based on relevant factors and within the agency's statutory authority." *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Ins. Co.*, 463 U.S. 29 (1983). The ultimate standard of review is an extremely narrow one. This Court is not allowed to substitute its judgment for that of the ALJ. *Citizens* at 416.

The standard for a preliminary injunction when coupled with the above-mentioned standard of review of an ALJ decision results in an extremely heavy burden for the plaintiffs in this case. Unfortunately, it also limits this Court's ability to render immediate justice in a situation, such as this, in which it finds the defendants' conduct particularly egregious. The result of this limitation is that despite the fact that Mr. Darby actually had little to do with the creation of the financing arrangement in this case, despite the fact that it was explicitly approved by HUD in Columbia and in Washington on

two separate occasions, and despite the troubling fact of HUD's inability to comprehend and/or apply its own regulations, and its complicity in this matter, this Court's hands are tied.

As noted above, when the plaintiff's likelihood of success on the merits is slight, the burden of showing irreparable injury is heavier. In this case, the plaintiffs have demonstrated economic injury which they will suffer if interim relief is not granted. However, given the balancing which must be done when the likelihood of success on the merits is not favorable, this Court would have to find that the financial impact is of considerable significance in order to grant the remedy sought. This Court does not find the financial injury in this case to be of a sufficient magnitude to override the plaintiffs' burden as to the likelihood of success on the merits.

The remaining two factors merit only brief discussion. The third factor for consideration is the injury to the defendant if an injunction is granted. Arguably, any injury to the government appears at first glance to be slight. However, the system of debarment is designed to insure that persons dealing in the area of government contracts do so carefully and fairly. If this Court were to grant an injunction under the facts of this case, the result would be to undermine the integrity of the debarment system. This also impacts adversely to the public interest, which is the fourth factor for consideration.

As noted above, all of the factors relevant to the granting of a preliminary injunction must be carefully balanced in making a determination as to whether to grant relief. After considering the pertinent factors in light of the circumstances presented in this case, this Court concludes that it must deny the motion for a preliminary injunction.

This ruling, however, should not be construed as a ruling on the ultimate success or failure of the merits of

the underlying action. A ruling on a motion for a preliminary injunction is not a substitute for an adjudication on the merits. Those matters must be left to an appropriate time when that decision is properly before the Court.

### CONCLUSION

For the reasons discussed above, the defendants' motion to dismiss is denied. Plaintiffs' motion for a preliminary injunction is also denied.

AND IT IS SO ORDERED.

/s/ David C. Norton  
DAVID C. NORTON  
United States District Judge

Charleston, South Carolina

October 25, 1990

### APPENDIX D

UNITED STATES OF AMERICA  
DEPARTMENT OF HOUSING AND URBAN  
DEVELOPMENT  
OFFICE OF ADMINISTRATIVE LAW JUDGES

HUDALJ 89-1373-DB (LDP)  
HUDALJ 89-1387-DB

IN THE MATTER OF: ROBERT GORDON DARBY, AND DARBY  
DEVELOPMENT COMPANY, INC.; DARBY REALTY COM-  
PANY; DARBY MANAGEMENT COMPANY, INC.; MD IN-  
VESTMENT; PARKBROOK ACRES ASSOCIATES; AND PARK-  
BROOK DEVELOPERS; AFFILIATES,

*Respondents.*

Ronnie Ann Wainwright, Esq.  
Bruce S. Albright, Esq.  
Andrea Q. Bernardo, Esq.  
For the Government

G. Richard Dunnells, Esq.  
Steven D. Gordon, Esq.  
Michael H. Ditton, Esq.  
For the Respondents

Before: WILLIAM C. CREGAR  
Administrative Law Judge

### INITIAL DECISION AND ORDER

#### Introduction

Respondent, Robert Gordon Darby, appeals from the imposition of a Limited Denial of Participation ("LDP") issued by the Columbia, South Carolina Office of the U.S.

Department of Housing and Urban Development ("HUD" or "the Department") on June 19, 1989. He also appeals a debarment proposed by HUD's Assistant Secretary for Housing on August 23, 1989. HUD proposes that Mr. Darby and his affiliates, Darby Development Company, Inc., Darby Realty Co., Darby Management Co., Inc., MD Investment, Parkbrook Acres Associates, and Parkbrook Developers be debarred from further participation in primary covered transactions and lower-tier covered transactions (*see* 24 CFR 24.110(a)(1)) as either participants or principals throughout the Executive Branch of the Federal Government, and from participating in procurement contracts with HUD for an indefinite period commencing on June 19, 1989.<sup>1</sup>

The LDP prohibits Respondent's participation in all programs administered by the Assistant Secretary for Housing in South Carolina for one year. The appeal of the LDP was consolidated with the appeal of the proposed debarment on September 13, 1989. A hearing on the consolidated appeals was held in Charleston, South Carolina, from December 19th to 22nd, 1989. Post-hearing briefs were filed on February 5, 1990.

The LDP and proposed debarment allege that Mr. Darby used a scheme which employed "strawbuyers" to obtain FHA single family mortgage insurance which he could not have otherwise obtained. The method used by Mr. Darby is alleged to have certain consequences which violate various HUD rules. First, it is claimed that the applications submitted to HUD by the "strawbuyers" contain false information. The Department contends that even if HUD employees knew the actual facts regarding the transactions, as opposed to those stated on the application, these employees could not waive the requirement that

<sup>1</sup> The August 23, 1989 letter proposed debarment for five years. By letter dated November 16, 1989, this letter was amended. Additional allegations were added and the length of the proposed debarment was increased to an indefinite period.

the applications be filled out truthfully. Second, the method used by Mr. Darby permitted him to obtain FHA mortgage commitments without making the minimum investments required by HUD rules. Third, this method circumvented safeguards established in the multifamily insurance program which should have applied to these properties. Finally, the consequence of Mr. Darby's actions was to saddle HUD with single family commitments, the loans for which he purposefully defaulted, thereby placing these properties in the HUD inventory. The Department contends that it cannot be estopped from debarring Mr. Darby and that his abuse of HUD programs was willful and so extensive as to warrant Mr. Darby's indefinite debarment.

Mr. Darby contends that the method used did not violate HUD regulations, and that there was a complete disclosure of the means used to obtain the insurance made to employees of the HUD Columbia Office which approved the mortgage insurance commitments. In addition, an employee at HUD Headquarters was advised of the method used and approved of it. He argues, therefore, that the Department is estopped from debarring him. He also provided evidence of his good character and reputation as well as the extensive efforts he made to reduce the damage to HUD once the defaults had occurred. As a result, he contends that neither the LDP nor the debarment is warranted, and, in any event, the proposed debarment for an indefinite period is far too severe for what occurred, and is, therefore, punitive<sup>2</sup>. He also notes that a considerable period has passed between the alleged misconduct and the LDP and debarment actions. In fact, changes have been made to HUD rules which would prevent Mr. Darby's present use of the method used at that time. Accordingly, he contends that no purpose is served by the LDP or a debarment for any period.

<sup>2</sup> HUD regulations prohibit the use of debarment for punitive purposes. 24 CFR 24.115(b).

## Findings of Fact

## General Background

Robert Gordon Darby is a self-employed real estate developer who conducts his business in South Carolina. He graduated from Newberry College, South Carolina, in 1961 and from the Northwestern University School of Mortgage Banking in 1963. He worked for Carolina National Mortgage Co. in Charleston until 1965. After working as a real estate agent, he formed the Darby Realty Company in 1968, selling residential real estate and insurance. In 1971, doing business as Darby Construction Co., he began building single family homes as well as several mobile home parks and single family subdivisions. He built approximately 1500 homes. In 1977, he stopped building single family homes, formed the Darby Development Company, and began developing and managing multifamily rental projects through that company. He developed approximately eight projects comprising approximately 1,000 units. (Tr. pp. 799-803) He began dealing with HUD in 1961 and has continued to work with HUD since that time. (Tr. p. 804) He is familiar with HUD single family and multifamily programs. He has a reputation in the HUD Columbia Office for honesty and professionalism. (Tr. pp. 390, 391, 586, 607)

Lonnie Garvin, Jr., is a mortgage banker. Also from South Carolina, he graduated from the University of South Carolina in 1958. He began his career with Southern Mortgage Company, an FHA approved mortgagee, in 1958. He worked his way from loan servicing agent through loan origination officer to president of the company in 1972. In 1976, he and other Southern Mortgage employees left to form a new company, Mid-South, which also became a HUD-approved mortgagee concentrating in HUD multifamily rental insurance programs. (Tr. pp. 651, 652) He was the president of Mid-South until

December 1985 when its parent company made the decision to relocate its principal activities to Greenville, South Carolina, at which time he left the company. (Tr. pp. 652, 653) Mr. Garvin has extensive experience with HUD programs, principally in the Section 221(d)(4) multifamily rental insurance program. He has a reputation in the HUD Columbia Office of being an extremely knowledgeable and trustworthy mortgagee. (Tr. pp. 408, 410, 587, 588)

In 1981, the real estate market in South Carolina was depressed. There was little single family or multifamily development activity due to high interest rates. (Tr. pp. 71, 73, 224, 225, 395, 451, 581, 657, 658, 808, 812) There was also a severe shortage of rental housing. (Tr. p. 657) In early 1981, Mr. Garvin originated a plan to use the existing HUD/FHA single family mortgage insurance program (12 U.S.C. Sec. 1709(b)) to finance the construction of rental units on existing lots. Once he obtained financing for the construction of the units, he would pay off the construction loans with the proceeds from the single family mortgage insured by HUD. Once the units were constructed, they would be rented. Mr. Garvin recognized that there would be a period where there would be a negative cash flow. This was because the rents could not be set high enough to offset the debt service resulting from the high interest rates. His plan envisioned the use of syndication. A syndicate would own the property and cover the operating deficits in return for tax write-offs for its limited partner investors. He also anticipated that the high rate of inflation would continue and would drive up rents. Once interest rates came down and the rents increased, a point would be reached when the properties could be sold or refinanced. (Tr. pp. 658-660) He expected this point to be reached in four to five years. (Tr. pp. 660, 661) The units were to be designed for resale as single family homes. They would have individual water meters, sewer taps, and

would be architecturally designed to blend with surrounding single family housing. (Tr. p. 659)

One of the principal HUD programs provides for the insurance of single family mortgages. This is authorized by Section 203(b) of the National Housing Act.<sup>3</sup> The purpose of the single family mortgage insurance program is to facilitate home ownership by owner-occupants. (Tr. pp. 33, 261, 330) However, until recently, limited use of the program by investors was permitted. (Tr. pp. 36, 190, 330).<sup>4</sup>

Although the HUD/FHA single family mortgage insurance program could be used for investment purposes in the early 1980s, this was not its primary purpose. The statute, as implemented by HUD, set forth certain restrictions on the use of this program for speculation. The two limitations pertinent to this case are: (1) the restrictions on the amount HUD can insure, i.e., minimum investment requirements and (2) limitations on the number of mortgages issued to a single borrower.

Section 203(b) establishes limits on the amount of a mortgage which HUD can insure. HUD can insure no

<sup>3</sup> 12 U.S.C. Sec. 1709(b).

<sup>4</sup> Two programs specifically authorized the use of this program by builders. These were the "builder escrow" commitment and the "builder bailout program". The first program permitted a builder to obtain a mortgage in his own name if the property were to be rented. His mortgage was limited to 85% of that available to an owner-occupant. This money was placed in escrow. In the event the property was not sold within 18 months, the amount placed in escrow would be applied to the mortgage and used to reduce HUD's commitment to what it would be for an investor. (Tr. p. 55, HUD HB 4000.2 Rev-1, para. 2-6(b)(4)). The second program permitted builders to refinance construction loans prompted by high interest rates. Again, builders were limited to a mortgage of 85% of that available to an owner-occupant. (Tr. p. 509) This program was temporary and existed from April 1980 to April 1981. (Tr. p. 37, 100). Neither of these programs was involved in this case. They do, however, demonstrate that under certain circumstances use of the program for investment purposes was permitted by Section 203(b).

more than 97% of the first \$25,000 and 95% of any amount in excess of the first \$25,000. Stated conversely, a minimum investment of 3% of the first \$25,000 and 5% of any amount in excess of \$25,000 is required to be paid by the borrower. (Tr. pp. 47, 77) As stated *supra*, investors were required to invest even more in the property, HUD's commitment being limited to 85% of the amount an owner-investor could obtain. (Tr. p. 76, HUD HB 4000.2 Rev-1, Para. 2-6(b)(4)(a) (April 1982)), Govt. Ex. G-154) The above rules applied to purchases. "Refinances" did not require any minimum investment.<sup>5</sup>

<sup>5</sup> The minimum amount of investment for purchase by an owner-occupant is the difference between the "cost of acquisition" and the maximum allowable mortgage amount. The "cost of acquisition" is the contract sales price plus closing costs. In a refinance transaction, there is no "cost of acquisition" and no requirement for a minimum investment (Tr. p. 77, HUD HB 4000.2 Rev-1, Para. 2-11, Govt. Ex. G-93, Govt. Ex. G-154)). An illustration of the differences between the two types of transactions (purchase versus refinance) is set forth in the Inspector General's audit as follows:

"To illustrate the calculation of the insured mortgage amount on the case we reviewed, we will use a property with acquisition costs of \$68,000 (\$66,600 sales price plus \$2,000 estimated closing costs) and an appraised value of \$80,000. Based on these amounts a calculation of the maximum mortgage follows:

	Acquisition Cost	Mortgage Amount
97% of	\$25,000	\$24,250
95% of	43,600	41,420
Total acquisition cost	68,600	\$65,670
Maximum mortgage for owner-occupant		65,670
		85%
Maximum mortgage for owner-non-occupant		\$55,800
Acquisition cost		\$68,600
Maximum mortgage		55,800
Minimum investment		\$12,800

Because the loans were represented as refinancing transactions instead of purchases, the mortgage insured by HUD was 85 percent

HUD also placed limitations on the number of properties for which HUD would commit mortgage insurance held by the same borrower. This "Rule of Seven", set forth in HUD regulations as early as December 1971, is stated in a HUD Handbook as follows:

- A mortgage on a property upon which there is a one to four family dwelling to be rented by the mortgagor is not eligible if the property is a part of, or adjacent or contiguous to a project, subdivision or group of similar rental properties which involve eight or more dwelling units in the mortgagor or principals have any financial interest in such properties. The terms "adjacent" and "contiguous" mean touching or adjoining.

(HUD HB 4155.1, Para. 1-14(g) (April 1977), Govt. Ex. G-153(a))<sup>6</sup>

Both of these restrictions are designed to limit defaults. The requirement for a minimum investment acts to reduce the amount of debt service. The restriction on the number of single family units held by the same borrower is designed to prevent mass defaults. (Tr. pp. 39, 277) If a large number of properties enter the HUD

of the maximum amount available to an owner-occupant using appraised value plus closing costs, without regard to acquisition cost and the minimum investment. In the case illustrated, the HUD-insured mortgage was \$66,600 instead of \$55,800:

	Appraised Value	Mortgage Amount
97% of	\$25,000	\$24,250
95% of	57,000	54,150
Total (including closing costs)	82,000	\$78,400
		85%
Insured mortgage amount		\$66,600
(Govt. Ex. G-93, p. 5) (Emphasis in original)		

<sup>6</sup> See also 24 CFR 203.42.

inventory in the same geographic area, the cost to the taxpayer will be markedly increased. First, the difficulty of selling an extensive supply of properties results in increased management fees. Second, the availability of an extensive supply of housing tends to reduce the sales price of the properties. (Tr. p. 39)

The "Rule of Seven" was intended to reduce the risk of mass defaults by limiting the number of single family mortgages held by the same borrower in a given location. In effect it draws an arbitrary line between single family and multifamily projects.<sup>7</sup> In the case of multifamily projects, HUD has attempted to deal with the risk of mass defaults in the underwriting process and by maintaining oversight of the projects once the mortgage commitments have been issued. The Department insures multifamily projects pursuant to Section 207 of the National Housing Act.<sup>8</sup> The approach used in underwriting involves a different method of valuation. A single family mortgage is evaluated by the relationship of the debt to the resale value of the property, whereas a multifamily project is evaluated by the relationship of the debt to the income it can produce.<sup>9</sup> (Tr. pp. 276, 353) If the amount

<sup>7</sup> Another distinction exists by virtue of the number of units in a particular "site". Any site with over four "rental dwelling units" is considered multifamily. 24 CFR 207.24(a). The Department does not contend that this rule was violated by Respondents.

<sup>8</sup> 12 U.S.C. Sec. 1702. There are two types of multifamily programs, "new construction" and "existing". Under the "new construction" program, Section 221, HUD will guarantee 90% of the net income. Under the "existing" housing program, Section 223(f), mortgages can be insured for the whole amount of developments which have been completed more than three years previously. (Tr. pp. 357-358)

<sup>9</sup> The Department determines the amount for which the units in the proposed project can be rented. It then estimates the "replacement cost" of a project and the "supportable cost". The "supportable cost" is the cost which can be supported by the projected income after subtracting the operating expenses. (Tr. p. 353)

of income is insufficient to support the debt, more "up front" money is required from the borrower. (Tr. p. 356) In addition, HUD requires: (1) a market analysis to determine financial feasibility; (2) cost certifications audited by independent public accountants to limit the maximum insured amount; and (3) "previous participation clearance" to evaluate the past performance of the borrower. (Govt. Ex. G-93, pp. 8, 9) HUD's oversight is accomplished through regulatory agreements<sup>10</sup>, management agreements<sup>11</sup>, the reporting of income and expenses, and model lease approval. HUD maintains the right to audit income and expenses and to require monthly market absorption reports. (Tr. pp. 353, 354) In addition to these requirements, HUD requires compliance with federal wage and hour laws and environmental protection laws. (Tr. pp. 358, 609)

As stated above, HUD rules in existence in the early 1980s provided for the insurance of existing mortgages as well as those incurred initially by way of a purchase and sale. These rules recognized that refinances differed from purchase and sale transactions in certain respects. The amount to be financed was less than for a new mortgage by an owner-occupant.<sup>12</sup> There was no "cost

<sup>10</sup> These provide HUD with certain controls over mortgagors. These controls include: (1) the requirement for an annual financial report certified by an independent public accountant; (2) a prohibition against paying out of funds except from surplus cash, except for reasonable operating expenses and necessary repairs, without HUD approval; and (3) HUD concurrence in any transfer of physical assets. (Govt. Ex. G-93, p.8)

<sup>11</sup> The management agreement must conform to the regulatory agreement. By approving the management agreement, HUD approves the management agent and management fee which is limited to those prevailing in the local area. (Govt. Ex. G-93, p. 8)

<sup>12</sup> The HUD rule in effect in 1982 states:

An existing mortgage, insured or uninsured, may be refinanced with a new mortgage insured under this section. The maximum mortgage amount and loan-to-value ratio is the same as if it

of acquisition" in a refinancing transaction since the property was already owned by the borrower. The amount to be financed was based upon HUD's appraisal of the actual value of the property.<sup>13</sup> There was a requirement for the verification of the existing mortgage. (Tr. p. 107) If the amount of the new loan exceeded the original mortgage, the borrower could "pull out" the excess cash. There were no limitations placed on the use to which this money could be put. (Tr. pp. 190, 191, 221)<sup>14</sup> A HUD Handbook prohibited the use of permanent loans to refinance construction loans. However, this Handbook was not distributed to mortgagees.<sup>15</sup>

The restrictions placed on the issuance of multifamily commitments make it easy to see why a developer or lender, faced with high interest rates and a sluggish environment for multifamily projects would prefer the single family mortgage insurance program. The chief obstacle was the "Rule of Seven".<sup>16</sup>

were a new mortgage, further limited to the larger of 85 percent of the amount of a new mortgage available to an owner-occupant, or the existing indebtedness related to the property plus the cost of repairs and refinancing. A statement of the purpose of the loan must accompany the application. (HUD HB 4000.2 Rev-1, Para. 2-11 (April 1982), Govt. Ex. G-154)

<sup>13</sup> Appraisers could be either HUD employees, or contract or "fee" appraisers. HUD also accepted appraisals made by the Veterans Administration. (Tr. p. 77)

<sup>14</sup> Cash could not be taken out after May 16, 1985. (Tr. p. 98, Govt. Ex. G-138)

<sup>15</sup> Handbook 4190.1 was referred to but not introduced into evidence by the Department. (Tr. pp. 208, 217, 221) Because it is not distributed to mortgagees and because there is no evidence that either Respondent or Mr. Garvin were aware of its provisions, I have not considered it as a basis for sanctioning Respondent.

<sup>16</sup> Since the mid 1970s, waivers of the Rule of Seven have been granted by the Department. (Tr. pp. 89, 314) A regulation providing for such waivers became effective on October 6, 1982. See 24 CFR 203.248. That regulation provides that a waiver can be granted

### The Garvin Transactions

In mid 1981, Mr. Garvin approached the HUD Columbia Office and learned from HUD employees, Henry Granat, Deputy Director for Housing Development, and Robert DesChamps, Chief of the Mortgage Credit Branch, that the application of the Rule of Seven would be satisfied by dividing up the units so that any particular borrower would have no more than seven units at the time of loan closing. (Tr. p. 663)<sup>17</sup> This entailed the use of an individual who would be given title to the

only in writing by the Secretary or Assistant Secretary for Housing. Recommendations for a waiver of the rule are made by the local field office and approved by the Assistant Secretary for Housing. (Tr. pp. 40, 88) Waivers were approved in 1982-1983. (Tr. p. 314) Bill Park, Chief of the Single Family Mortgage Credit Branch in Headquarters, testified that, from the mid 1970s to 1985, waivers were seldom requested and were not normally granted. (Tr. pp. 89-90) He testified that, from 1985 to 1987, it was fairly typical to grant waivers in cases involving refinance transactions where investors with pre-existing HUD-insured loans sought to obtain lower interest rates. (Tr. p. 90). Mr. Nistler testified that, with regard to the period from February 1984 to March 1989, his tenure as Deputy Assistant Secretary for Single Family Housing, he does not recall an instance where a request for a waiver was denied. (Tr. 513)

<sup>17</sup> Mr. Garvin testified as follows:

I asked what did they mean by that and I was told that a geographic area was a particular subdivision. And I specifically asked the question, "Then you're saying if I'm in subdivision A, we can do seven units but if I move across the street to subdivision B, we can do seven more, that's a different geographic area." I was told yes. And then I inquired as to when the Rule of Seven applied and I was told that it applied at the time of loan closing. At the time the loans were closed, one individual could not have more than seven units. In fact, we even had a discussion as to how you do duplexes if you were limited to seven units, could you do seven duplexes or could you do three and a half duplexes. . . The answer was it was units, we had to do three and a half and we could take two people together and use their halves to get 14 units out of two people.

(Tr. pp. 662-663)

property prior to closing and would subsequently transfer it to a syndicate. The individuals selected for this purpose were the employees of Mid-South.

The prototype for this method was a 30-unit duplex consisting of 15 duplexes called Plantation Ridge. Mid-South's development company, Tandem Development, and Southern Homebuilders, a construction company, formed a development partnership. This partnership located single family duplex lots and obtained options to purchase these lots based on obtaining HUD firm commitments for Section 203(b) mortgage insurance. Plans and specifications were submitted to the HUD Columbia Office together with applications for conditional commitments.

The issuance of mortgage commitments is a three-step process. The first step involves the issuance of conditional commitments. A lender submits an application and an appraisal is requested. After the site is evaluated and the property appraised,<sup>18</sup> construction can begin. Inspections are made during the construction phase and a final inspection report is issued. (Tr. pp. 397-402) The Valuation Branch is responsible during this phase.<sup>19</sup> The second step, or firm commitment process, involves the evaluation of the borrower's credit. This is done by the Mortgage Credit Branch, based upon application (HUD Form 92900) submitted by the borrower. After credit approval, a "firm commitment" is issued. The third step, insurance of the mortgage, takes place only after credit approval and final inspection.

The HUD Columbia Office, in accordance with single family commitment procedures, reviewed the plans and

<sup>18</sup> Since there was no established purchase price, HUD appraisers determined the value of the property.

<sup>19</sup> The Rule of Seven does not apply to conditional commitments as the identity of the mortgagor is not known. There is no reference to the rule in the HUD Single Family Valuation Handbooks. (R. Ex. G, Tr. p. 469)

specifications, appraised the value of the finished units, and issued conditional commitments. Subsequently, a syndication, known as the March Company, agreed to syndicate the Plantation Ridge Development.

Mid-South prepared applications for firm commitments for mortgage insurance using a HUD Standard Form 92900.1, "HUD/FHA Application for Commitment for Insurance under the National Housing Act". (Tr. pp. 668, 669). These applications were signed by employees of Mid-South.<sup>20</sup>

Blocks 8(a) and 24(m) set forth the amount of the loan. This amount was determined by calculating the maximum insured mortgage amount based on the HUD appraisal. (Tr. p. 673)

Block 9(a) of the form states the purpose of the loan. This information assists HUD in determining the maximum loan amount. (Tr. p. 78) There are eight possibilities one of which is to be selected by checking the appropriate block. The blocks include the "purchase of an existing house previously occupied", purchasing an "existing home not previously occupied", "constructing a home-proceeds to be paid out of construction", or "refinance". In each case, the "refinance" block was checked.

Block 9(b) contains information regarding the type of borrower. The choices include "occupant", "builder", or "landlord". In each case the "landlord" block was checked.

Block 15 lists the estimated monthly payment, including debt service, taxes, etc. The amount shown on the application exceeds the estimated rental income listed in Block 23(a). Thus anyone reading the form would note that there is a shortfall.

<sup>20</sup> The applications, generically described below, are those submitted by Mr. Garvin and his employees in connection with Plantation Ridge and other projects. The Department introduced 89 exhibits containing various applications which involved the Respondent. (Govt. Exs. G-38 (d) to G-89 (d))

Blocks 21 and 22 list the applicant's assets and liabilities. Those listed were the personal assets and liabilities of the applying Mid-South employee, not those of the ultimate owner.

Block 24 contains spaces for the listing of the individual cost items comprising the total estimated cost of the property. This was calculated by estimating prepaid items, discounts, and closing costs, etc., and subtracting this amount from the HUD maximum insured amount listed in blocks 8(a) and 24(m). Block 24 is part of Section II of the form. Block 24(f) is checked if the borrower is applying to refinance a loan. (Tr. pp. 674-676) The forms were filled out with the notation, "payoff const. [construction] loan".

Block 31 is located in Section V of the form which is entitled "Borrowers Certification". Block 31(a)(1) asks, "Do you own or have you sold, within the past 12 months, other real estate?" This question is followed by six blocks which break the question into three separate components with "yes" or "no" answers. The question relating to ownership is answered, "yes." The next question "is it to be sold?" is answered, "no". The final question asks if it is a HUD/FHA mortgage. This question is answered, "yes".

Block 31(a)(3) asks, "If the dwelling to be covered by this mortgage is to be rented, is it a part of, adjacent or contiguous to any project, subdivision, or group rental properties involving eight or more dwelling units in which you have any financial interest?" In each case the block checked is "no". If the question were answered in the affirmative, a further question asks for details.

Block 31(b)(5) contains the following language: "The borrower certifies that all information in this application is given for the purpose of obtaining a loan to be insured under the National Housing Act, or guaranteed by the Veterans Administration and the information in Section

II is true and complete to the best of his/her knowledge and belief."

Block 33 states the following: "(S)ignature of borrower(s) (before signing, review accuracy of application and certifications.)"

Following the signature block and located at the bottom of the form is the following statement in bold print: "Federal statutes provide severe penalties for any fraud, intentional misrepresentation, or criminal connivance or conspiracy purposed to influence the issuance of any guarantee or issuance by the VA or USDA-FmHA Administrator or the HUD/FHA Commissioner."

The loan proceeds were to be used to refinance and pay off the construction loans that would be used to build the units with permanent financing at a relatively low rate. In the case of Plantation Ridge and other properties to follow, the construction loan was not obtained until after firm commitments were issued by HUD since the proposed construction lender required assurance that permanent financing would be available to pay off the construction loan. (Tr. pp. 670, 674) This is standard industry practice. (Tr. p. 670) Since construction lenders typically loan less than the value of the completed home, each of these transactions resulted in a surplus. (Tr. p. 675) This surplus could be pulled out of the transaction under existing HUD rules. (Tr. pp. 98, 678, Govt. Ex. G-138)

After the applications for firm commitments were prepared by Mid-South, Mr. Garvin again met with Mr. DesChamps and Mr. Granat. This meeting occurred in November 1981. At the meeting, Mr. Garvin made clear to these HUD employees the following elements of his plan: (a) that he (Mr. Garvin) was proposing the construction of projects consisting of more than seven units (Tr. pp. 452); (b) the Section 203(b) single family insurance program would be used for permanent financ-

ing of this construction (Tr. pp. 452, 453); (c) the applications would be made in the name of Mid-South employees in order to comply with the Rule of Seven (Tr. p. 453); (d) these employees would obtain title to properties, seven at a time, and transfer the properties to a syndicate (Tr. pp. 431, 432, 453, 454); and (e) the syndicate would cover the "shortfall" in return for tax write-offs (Tr. pp. 454, 455). What they were not told was that individuals owning interests in the entities transferring the properties to the Mid-South employees would get the properties back through other entities in which they also owned interests. (Tr. pp. 468, 469) Although these HUD employees did not realize initially that these transactions would be characterized by the borrowers as "refinances", they should have known this as soon as the applications were received. (Tr. pp. 431, 432)

Mr. DesChamps, at the direction of Mr. Granat and in the presence of Mr. Garvin, called HUD Headquarters in Washington, D.C., for advice. He spoke with Ruth Studer, a HUD employee in the Headquarters Single Family Division, Mortgage Credit Section. Ms. Studer was at that time one of two staff employees responsible for answering questions from the field relating to the single family mortgage credit programs. (Tr. pp. 59, 67) She had considerable expertise in this area and was described as the "point person" for dealing with field questions by the former Deputy Assistant Secretary for Single Family Housing, James Nistler. (Tr. p. 514) Based upon the description of the transaction she was given, she advised that HUD program requirements would not be violated.<sup>21</sup>

<sup>21</sup> Ms. Studer, who is now retired, does not remember either this conversation or the subsequent conversation discussed below. She testified that she received approximately thirty questions relating to the Rule of Seven per week. (Tr. p. 331) She testified that she would have said it would be consistent with HUD rules for an individual who had obtained FHA loans on seven units to sell or transfer

Mr. DesChamps prepared a memorandum of his conversation with Ms. Studer which is dated November 24, 1981. Delphic in its ambiguity, this document states that the thirty duplex proposal was described to Ms. Studer and that she said "... it was legal provided the Mortgage Credit Section imposed its limited ownership rules on the proposed mortgagors." (Govt. Ex. G-109)<sup>22</sup>

The HUD Columbia Office approved the firm commitment applications for Plantation Ridge. A construction loan was secured by the Tandem/Southern Homebuilders' partnership. The homes were built and inspected by HUD during the construction. Upon completion, a final inspection was given. This is a prerequisite to the issuance of the mortgage insurance. (Tr. pp. 681, 709) Since Mr. Garvin intended this arrangement to constitute the refinancing of a construction loan, he understood that it was necessary for the "borrowers" to have title at the time of closing.<sup>23</sup> Thus, prior to closing these transactions, Tandem/Southern transferred the title to the units to the individual Mid-South employees. After closing, these same individuals transferred title to a syndicated limited partnership which owned and operated the units as Plantation Ridge Development. Tandem Development was the corporate general partner with a 1/2 of one per-

the properties and come back for seven more as long as there was no continuing financial interest held by the seller. (Tr. p. 334)

<sup>22</sup> The memorandum indicates that the primary concern of Messrs. DesChamps and Garvin was whether the Rule of Seven applied to seven units or seven duplexes. She told them it meant units.

<sup>23</sup> Where an individual borrows money to purchase property in the first instance, that purchaser does not have title at closing. (Tr. p. 433) Where an individual borrows money to refinance, he/she necessarily has title before closing. Because Mr. Garvin intended to characterize these transactions as refinances, he had to demonstrate that the borrowers had title no later than the closing. This is consistent with Mr. Garvin having been told by HUD Columbia Office employees that the relevant time for purposes of applying the Rule of Seven was the time of closing. (Tr. p. 663)

cent interest. The other general partner, also with a 1/2 of one percent interest, was Mr. Garvin. (Tr. p. 681) The limited partners held the remaining 99 percent.

The limited partnership was syndicated through the March Company. (Tr. p. 682) It took title to the units "subject to" the insured mortgages rather than "assuming" the mortgages. Assumption of the mortgages would have adversely affected the tax basis of the limited partnership and its partners (Tr. pp. 687, 688, 693, R. Ex. RR) The "borrowers" remained contingently liable on the mortgages. (Tr. p. 776)

Subsequently, Mid-South used the Plantation Ridge financing and syndication process for other developments.<sup>24</sup> Between 1981 and 1984, Mid-South processed approximately 1050 Section 203(b) applications through the HUD Columbia Office. Over 1600 units were developed. (Tr. pp. 704, 705) At the HUD Columbia Office most of these applications were processed by one man, Charles Bennett, who worked under the supervision of Mr. DesChamps. (Tr. p. 602) There was no attempt to conceal these transactions. Application packages too bulky to mail were grouped together and sent by Mid-South in boxes by bus to the HUD Columbia Office. Mr. Bennett "kept score" to make sure that no Mid-South employee had title to more than seven properties at a time. (Tr. pp. 683, 686) Upon completion of the Plantation Ridge transactions, Mr. Garvin advised Mr. DesChamps by letter that the "individual owners" deeded the property to Plantation Ridge Associates which was now financially and legally responsible for the units.

<sup>24</sup> After other projects were developed, U.S. Shelter Corporation, the parent of Mid-South, became the management agent for most of the projects. The general partners executed operating deficit loan agreements with the limited partnerships agreeing to fund the operating deficits for a specific period, usually four to five years. The permanent loans were placed in GNMA Mortgage-Backed Securities Pools. (Govt. Ex. G-93, pp. 1-2)

(R. Ex. NNN). Other letters and reports on the status of the later projects were sent by Mr. Garvin to Mr. DesChamps. These clearly establish that Mr. DesChamps knew that the applicants for firm commitments were not, in fact, and were never intended to be, the ultimate purchasers.<sup>25</sup>

While HUD employees in Columbia knew of and approved the financing pattern, they only slowly became aware of the extent of its use by Mid-South. This was because HUD did not have a tracking system to match the volume of applications for units with the geographic locations of these units. (Tr. p. 383) At some point in early 1983, the Director of Housing and Mr. Granat made a site visit to one or more of Mid-South's projects. (Tr. p. 466) Their report resulted in the first conscious realization by HUD Columbia Office personnel of the extent and location of the rental projects Mid-South was financing under the single family mortgage insurance program. In the understated words of Mr. DesChamps, "we got a little burned." (Tr. p. 467)

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<sup>25</sup> On April 23, 1982, Mr. Garvin requested Mr. DesChamps to reconsider his rejection of the application of a Wayne Baker in another development, Tarpon Bay II, because of his insufficient funds. Mr. Garvin pointed out that Mr. Baker's funds were actually going to be covered by the tax syndication. He also requested that Baker's name be substituted on applications which had previously been approved in Mr. Garvin's own name because the March Company had determined that Mr. Garvin's role as applicant conflicted with his role as general partner. (R. Ex. QQ) On June 30, 1982, Mr. Garvin requested Mr. DesChamps to substitute another borrower, Mr. Tucker, because he was to become a general partner in the Tarpon Bay II partnership. (R. Ex. RR) On March 31, 1983, Mr. Garvin wrote to Mr. DesChamps informing him that Plantation Ridge and Tarpon Bay II were completed. He stated that "[o]ur people no longer have any financial responsibility for those units." The rest of the letter goes on to tell Mr. DesChamps about the progress of other developments, Oak Ridge, Greenhurst, Maritimes and Parkbrook Acres. (R. Ex. TT)

This knowledge stanching neither the flow, nor approval, of Mid-South applications, however. Mr. Granat asked his section chiefs to review the correctness of their approval of the applications and was told by them that everything was in order. (Tr. p. 599) Just to make sure, Mr. DesChamps again contacted Ms. Studer on March 30, 1983. A memorandum to Mr. Granat of this conversation was prepared on April 8, 1983.<sup>26</sup> This memorandum states a great deal more about the nature of the transactions than the previous memorandum of November 24, 1981. In the memorandum Mr. DesChamps states that he explained to Ms. Studer, "in detail," that "we were issuing firm commitments to applicants who were closing the loans and then transferring ownership to the March Company for syndication. The March Company in turn was selling ownership to Limited Partners as investors." Mr. DesChamps states that he asked Ms. Studer whether HUD should be concerned with the "one entity ownership" of these units. She replied that although the ideal way to transfer title would be through the use of an assumption, HUD had no control over what the owners did with the property since it was "invested in fee simple". A mortgagor could elect not to assign and transfer the mortgage, thus retaining a contingent liability. The possibility of violating the Davis-Bacon wage and hour requirements was also discussed. The memorandum claims Ms. Studer was unconcerned with this and that what Mid-South was doing was "quite prevalent in California." The answer "no" to the question on the application concerning the ownership of more than seven units was also discussed. According to the Memorandum, Ms. Studer stated this answer should not be questioned because "this was [the applicant's] statement over his signature and certification." (Govt. Ex. G-111)

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<sup>26</sup> Again, Ms. Studer has no independent recollection of the conversation. (Tr. p. 331)

During this period the HUD Columbia Office was headed by Franklin H. Corley, Jr. He first focused on the Mid-South financing pattern in the Spring of 1983. (Tr. p. 373) It was brought to his attention by office employees who were concerned with the volume of units being generated by Mid-South. In addition, another builder had asked permission to use Mid-South's methods to finance its own properties. Mr. Corley orally advised the builder that he could use the Mid-South financing program because HUD Columbia "had permission from Washington to go in this direction." The builder "came back about two weeks later stating that his attorney advised him not to participate in this because he felt like it was a violation of the multifamily rules and regulations." (Tr. pp. 379, 380) Mr. Corley asked his staff to prepare a memorandum summarizing the Mid-South financing methods. Mr. Garvin was asked to provide information regarding the number of units for which commitments were issued together with their location. Mr. Garvin did so. (Tr. pp. 381-383). The requested memorandum, dated August 30, 1983, was sent to Philip Abrams, Acting Assistant Secretary for Housing/FHA Commissioner. The memorandum describes the transaction as follows:

Attached is a confidential outline of a *proposal . . . as a vehicle for financing groups of duplex units to be constructed in South Carolina.*

We have information that indicates these principals *wish to construct 1600 such units throughout South Carolina, using this same financing arrangement. The contractors expect to sell the individual duplexes to the officers and employees of the Tandem Company who will close the loan on that unit. After the closing of the permanent loan on each duplex, it will be sold to the partnership subject to the FHA insured loan under Section 203(b).*

(Emphasis added) (Govt. Ex. G-112)

The memorandum goes on to state, "We are concerned with the monitoring of a program so wide in scope as well as the risk of exposure we would have under the single entity ownership of the rental properties during the term of the insured loan." (Id.) Mr. Corley's memorandum is misleading. It does not reflect that the financing arrangement was a *fait accompli*; rather it is referred to as a "proposal" and is written in the future tense.<sup>27</sup>

Mr. Abrams' reply, dated September 23, 1983, states that the "proposal" is "unacceptable". It notes that the plan is a vehicle to circumvent the regulations limiting the number of closely located rental units in which the same mortgagor may have a financial interest and that there are no "long term risks to the partnership." (Govt. Ex. G-114) Because the memorandum to Mr. Abrams did not advise HUD Headquarters that Mid-South's activities had already been approved by the HUD Columbia Office in numerous cases, the reply does not require any corrective action.

Upon receipt of the Abrams' reply, the HUD Columbia Office stopped the approval of new applications but continued to process and approve firm commitments for 53 conditional commitments already issued to Mid-South. (Tr. pp. 706, 776, Govt. Ex. 93, p. 9) Mr. Corley offered to accompany Mr. Garvin to appeal HUD's decision. Mr. Garvin declined because he felt that ". . . we had all the property we could manage properly and handle." (Tr. pp. 706, 776, 785)

## The Darby Transactions

### I. Bay Tree and Oakfield

Mr. Darby's utilization of Mid-South's financing methods began in mid-1982. He had previously purchased two properties, Bay Tree, located in Mt. Pleasant, South

<sup>27</sup> Mr. Corley does not remember signing this memorandum but is familiar with it. (Govt. Ex. G-112, Tr. p. 379)

Carolina, and Oakfield, located in North Charleston, South Carolina. The Bay Tree and Oakfield developments involved existing housing units. These financing arrangements differed from the projects developed by Mr. Garvin in that the mortgages were assumed by Darby Development, Inc., and were not syndicated. Mr. Darby paid off the construction loans, but he and his company remained liable on the new mortgages. Mr. Darby used the syndication method advised by Mr. Garvin in developing Parkbrook Acres.

Bay Tree originally consisted of 25 single lots and 175 townhouse lots. (Tr. pp. 805, 806) He sold the single lots, and built townhouses on the remaining lots. As interest rates rose, he found himself with 35 completed but unsold townhouses which are the subject of the transactions at issue. Two of these were held in his own name, the rest were owned by Darby Development Company of which he was sole owner. Mr. Darby had outstanding construction loans on these properties tied to the prime rate which was running as high as 21%. (Tr. pp. 807, 811, 812)

The Oakfield development consisted of nine townhouses similar to those at Bay Tree. Title to these properties was held by MD Investment, a partnership between Mr. Darby and Curtis Martin, a builder. As was the case with Bay Tree, Mr. Darby could not sell these units because of high interest rates. At the same time, he was burdened with construction loans tied to the prime rate. (Tr. p. 812)

Mr. Darby needed to obtain permanent financing at a lower rate. In mid-1982, he learned that FHA money was available at the rate of 12% from Howard Russell of Standard Federal Savings and Loan. (Tr. p. 815) He also knew that Mr. Garvin was able to obtain FHA permanent financing for duplex projects. In mid-1982, he asked Mr. Garvin how it was done. Mr. Garvin explained the Mid-South financing methods, and told him that it had HUD approval. (Tr. pp. 812, 813, 819) Mr.

Darby had done business with Mr. Garvin for many years and never had any reason to question Mr. Garvin's integrity. (Tr. pp. 819-821) At this time Mr. Darby had been trying to arrange permanent financing from Cambridge Mortgage Company. After learning of Mr. Garvin's method he asked Cambridge to arrange permanent financing for Bay Tree and Oakfield. Cambridge experienced difficulties in completing the applications and frequently resorted to Mr. Garvin for assistance. (Tr. pp. 702, 703, 774, 775) Mr. Garvin decided it was easier to do it himself rather than explain the process to Cambridge. (Tr. pp. 702, 703, 774, 775, 815)

Following the Mid-South examples, Mr. Darby completed seven applications in his own name.<sup>28</sup> (Tr. p. 816, Govt. Exs. G-32 (d) to G-37 (d)) The remaining applications for Bay Tree and Oakfield were signed by individual Mid-South employees or Mr. Garvin as "mortgagors". (Tr. p. 816, Govt. Exs. G-1 (d) to G-31 (d)) These applications were completed as a favor to Mr. Darby by Mr. Garvin. No origination fees were paid to Mid-South. (Tr. pp. 703, 705)

The applications were completed in the following manner:

<sup>28</sup> Seven sets of deeds evidence a transfer from his wholly owned company, Darby Development, to Respondent, and back to Darby Development. Respondent testified that the seven applications signed by him were the result of a mistake. These applications were prepared by Cambridge rather than Mid-South and were made out in his own name rather than Darby Development. In his dealings with Cambridge he often signed his own name on behalf of Darby Development. Since his relationship with local lenders was rather informal, he could later call up the lender and indicate the entity which would acquire the title. In this case, he did not realize his mistake until after HUD issued its commitments. Time being of the essence in order to secure financing, he decided not to wait for three additional weeks for HUD to issue a commitment in the name Darby Development. Although admittedly improper, using himself as the "borrower" saved time. (Tr. pp. 816-818)

1. Blocks 8 (a) and 24 (m) set forth the amount of the loan as determined by the HUD appraisal.

2. Block 9 (a) which requests the borrower to state the purpose of the loan was checked "refinance".

3. Block 9 (b) which asks the borrower to state his intended relationship to the property is checked "landlord".

4. Block 15 (the estimated monthly payment) exceeds the amount listed in Block 23 (the estimated income from the property to be "refinanced"). Thus a shortfall is clearly stated on the form.

5. Blocks 21 and 22 list the assets and liabilities of the individual Mid-South employee, Mr. Garvin, or on the seven applications which Mr. Darby, himself, signed the assets and liabilities of Mr. Darby.

6. Block 24 lists the individual cost items comprising the total estimated cost. Block 24 (f) states the word, "refinance". Except for the individual Darby applications, next to this word is the phrase, "pay off const. loan". (Govt. Exs. G-32 (d) to G-37 (d))

7. Block 31 (a) (1) which asks whether the borrower owns or has sold other real estate within the last 12 months is answered "yes" with regard to ownership and "no" with regard to whether it is to be sold.

8. Block 31 (a) (3) specifically incorporates the Rule of Seven. The application asks whether if the dwelling is to be rented it is part of, adjacent or contiguous to any project, subdivision, or group rental properties involving eight or more dwelling units in which the borrower has a financial interest. In each case this block is checked "no".

9. Block 33 requiring the certification that the information contained in Section II is true and complete to the best of the borrowers knowledge and belief as well is signed by the "borrower".

The applications were signed on various dates between September and November of 1982. HUD issued firm commitments in the names of Lonnie Garvin, Jr., R. Gordon Darby, and Mid-South employees, Porter Kinard, Watson Chamberlin, and Eugene Garvin. The loan closings took place in January 1983. Standard Federal Savings and Loan issued the mortgages. Respondent did not make the investment in the property he would have been required to make had the transactions been treated as purchases.<sup>29</sup> Most of the loan proceeds were used to pay off construction loans. The excess amount remaining after paying off the loans was endorsed over to Mr. Darby or Darby Development Company. (Tr. p. 94, Govt. Ex. G-95) This amounted to \$529,000. (Tr. p. 155, 162-165, Govt. Ex. G-95)

The properties were "transferred" from Darby Development, Inc., to the Mid-South employee, Mr. Garvin or Mr. Darby and from that individual back to Darby Development, Inc. The mechanism used for the "transfers" was a deed. Each deed contains the following language:

(Grantor) in the State aforesaid, for/and in consideration of the sum of five and 00/100 (\$5.00) dollars and assumption of the hereinbelow described mortgage to it in hand paid at and before the sealing of these presents, by (Grantee) in the State aforesaid, and (the receipt whereof is hereby acknowledged) have granted, bargained, sold and released, and by the Presents to grant, bargain, sell and release, unto the said (Grantee), his heirs and assigns, the following described property. . . ."

(Emphasis added) (Govt. Ex. G-91)

<sup>29</sup> The record does not establish, nor does Respondent contend, that any funds invested he invested in the Bay Tree or Oakfield properties, prior to obtaining the firm commitments, i.e., payments on the construction loans, were sufficient to meet the minimum investment requirement.

One set of deeds reflects that the property was sold to the "borrower" prior to the respective closings. Another set shows that the new owner sold the property back to the original owner approximately three weeks after closing. For example, Darby Development, Inc., sold Porter Kinard the unit at 662 Swinton Court in Bay Tree on January 29, 1983. The property closed on January 31, 1983. Another deed reflects that Mr. Kinard sold the property back to Darby Development, Inc., on February 21, 1983. (Govt. Exs. G-16 (h), G-91)

## II. Parkbrook Acres

Parkbrook Acres was a combination of three projects located in three separate subdivisions, Millbrook, Gadsden Acres and College Park. (Tr. p. 697) Millbrook was owned by Mr. Darby, Gadsden was owned by Tandem, and College Park was owned by a general partnership consisting of Mr. Darby and Tandem. (Tr. pp. 696, 697, 822) Two new partnerships were formed, Parkbrook Developers and Parkbrook Acres Associates. The development partnership consisted of Tandem and Mr. Darby. On the other hand, Parkbrook Acres Associates served as the syndication partnership. One per cent of the ownership was held by the general partners, Tandem, Mr. Garvin, and Mr. Darby. The remaining 99% was owned by limited partners. (Tr. pp. 699, 700)

The Parkbrook applications followed the method used for Mr. Garvin's Plantation Ridge. There were 52 properties involved in these transactions. (Govt. Exs. G-38 to G-89) The applications were submitted between August and November 1982. By that time HUD had approved approximately 160 applications for other similar projects. (Tr. pp. 207, 698) The deeds reflect sales from Parkbrook Developers to a Mid-South employee prior to closing. After closing, other deeds reflect sales from Mid-South employees to Parkbrook Acres Associates. (Tr. pp. 210-212, Govt. Exs. G-38 to B-89, G-91) All deeds

were taken "subject to" the mortgage issued by Mid-South. Mr. Darby did not prepare the applications or act as "borrower" himself. On behalf of Parkbrook Developers, he signed not only deeds conveying the property, but also HUD Settlement Statements. For example, a deed showing a sale of Lot 144-A in Millbrook Subdivision from Parkbrook Developers to John E. Blackwell was executed on April 8, 1983. The deed was signed by Mr. Darby and Mr. Garvin for Parkbrook Developers. The closing also took place on that date. A subsequent deed, dated April 25, 1983, evidence a sale from Mr. Blackwell to Parkbrook Acres Associates subject to existing mortgages. (Govt. Ex. G-60) Parkbrook Developers "took out" \$440,000 from these transactions.

## Default and Workout Attempts

The Bay Tree, Oakfield and Parkbrook units were rented. However, things did not go as Mr. Darby and Mr. Garvin had planned. Changes to the tax law and the widespread use of low rate, tax exempt bonds resulted in increased competition for rental units in the Charleston area. (Tr. pp. 706, 707, 793, 826, 827) By 1986, Messrs. Darby and Garvin were faced with lower rents and destruction of the local rental market. This caused tenants to leave. A drop in the rate of inflation also affected the resale value of these units. Mr. Garvin's original economic assumptions proved to be wrong. Where he had expected a negative cash flow to continue for a few years, he had also expected the inflation rate to remain high, eventually generating a profit from the sale of the units. Now he and Mr. Darby were faced not only with a worsening cash flow, but now there was no end in sight because the inflation rate had come down. The Mid-South syndications continued to cover the operating deficits for Parkbrook. Mr. Darby had to cover Bay Tree and Oakfield himself. During the period from 1983 to September 1986, Mr. Darby spent \$553,000 on Bay Tree and Oakfield. This combined with the effect of the depressed

market on his other properties caused him to lose \$150,000 per month. (Tr. p. 829)

Mr. Darby contacted investor limited partners and his banks for financial assistance and arranged work-outs on his conventionally-financed properties. (Tr. pp. 829, 830, 857) He was unable to do this with Bay Tree and Oakfield since he and Darby Development, Inc., were the sole owners of the properties. Sometime in January 1986, Mr. Darby contacted the Deputy Manager of the HUD Columbia Office, Ron Rash. Mr. Darby proposed refinancing the loans since interest rates had dropped, otherwise he suggested there was a possibility he might be forced to default. (Tr. pp. 829, 831) Mr Rash told him that because of widespread "abuse" of the Rule of Seven, his office was not in a position to assist him. He suggested that Mr. Darby contact the HUD Regional Office in Atlanta.

Mr. Darby spoke with Timothy Raines, Director of the Program Support Division in the HUD Atlanta Office. Mr. Darby explained the financing arrangements surrounding the Bay Tree and Oakfield developments. He explained that loans had been originated in the name of employees and transferred to the Darby Development Company so that no person would have more than seven properties at a time. (Tr. p. 483) Mr. Darby argued that refinancing would benefit HUD since lower rates meant less risk of default. He also pointed out that under new rules, mortgage insurance premiums would be paid in a lump sum rather than over the period of the mortgage. During Mr. Darby's explanation of the financing arrangement, Mr. Raines recalls having heard Mr. Darby state, "... well we may have abused the program, but we didn't do anything illegal." He stated that he remembered this because it seemed to him to be quite "brazen". (Tr. p. 486) Mr. Darby's version of this conversation is that he was alluding to a characterization used by Mr. Rash in his previous conversation. Mr. Darby recalls

having said, "Y'all may think we abused the program, but we didn't do anything illegal." (Tr. p. 832) I find that Mr. Darby's version is the more likely of the two. Not only was he forthcoming to Mr. Raines about what occurred, but as an experienced businessman, it is unlikely that he would have made a statement, amounting to a taunt, when he badly needed HUD's help in extricating himself from his situation. Such "taunting" behavior is also inconsistent with the quiet, studied manner he displayed during his testimony at the hearing.

Mr. Garvin was also having problems. U.S. Shelter, the parent company of Mid-South, was experiencing financial difficulties. For a time it had funded the operating deficits, after the corporate general partners for the various Mid-South projects had stopped doing so. (Govt. Ex. G-93, p. 2) Mr. Garvin had been put on notice that U.S. Shelter might not be able to continue covering the operating deficits. (Tr. pp. 782, 783) He contacted HUD on January 6, 1986. At this time the loans were current. (Tr. 515, 782) In the Spring of 1986, U.S. Shelter went into default. (R. Exs. XX pp. 3, 5, 9-16, 21, 25) Shortly thereafter, U.S. Shelter requested HUD to accept an assignment of the single-family mortgages which would have resulted in an immediate claim payment of an amount in excess of \$52,000,000. HUD refused to accept an assignment on legal and policy grounds.<sup>30</sup> The enormous potential financial loss resulting

<sup>30</sup> Section 230 of the National Housing Act permits the Secretary to accept assignments only if: (1) the default was caused by circumstances beyond the mortgagor's control; and (2) the problem was temporary and could be corrected (interpreted by HUD to be within 36 months). It was the second ground which HUD determined could not be met. To have accepted assignment, three policy changes would have resulted. These were: (1) to permit defaulted mortgagors to qualify under the assignment program because of reduced interest rates; (2) to legitimize the use of the single family program by investors including partnerships and corporations; and (3) to qualify as "circumstances beyond control" a situation where

from default and foreclosure caused the parties to seek some way of reaching an accommodation.

In order to structure a workout, avoid FHA insurance claims, and prevent the loss of the projects, Mr. Garvin began a negotiation process with HUD Headquarters which lasted the next two and one-half years. Traveling back and forth between South Carolina and Washington, D.C. at his expense, he met with senior HUD officials including the Assistant Secretary for Housing and the Deputy Assistant Secretary for Single Family Housing. (Tr. p. 780) Mr. Darby joined in these workout negotiations and spent over \$6,000 in airfare alone. (Tr. p. 825)

A number of proposals were studied, considered, and rejected by HUD. One idea was to bring in outside financing with outside mortgagees. This would have released South Carolina National Bank and the other mortgagees. After this became unlikely there was also an attempt to work out an arrangement with South Carolina National Bank to hold the loan portfolio under a HUD approved mortgage modification agreement. (Tr. pp. 528, 529, Govt. Ex. G-144, p. 2) These proposals fell through because U.S. Shelter could not guarantee a sufficiently high interest rate. (Govt. Ex. G-144, pp. 2, 3, Tr. p. 528) Consideration was given to a plan whereby HUD would accept an assignment of the loans and enter into a workout and mortgage modification agreement with Mr. Darby and other partnerships. The Under Secretary of the Department rejected this proposal as he did not want to establish a precedent for doing this. (Tr. pp. 530, 568, Govt. Ex. G-144, p. 3) The fourth and last proposal was to refinance the entire portfolio under HUD's Section 223 (f) multifamily program. (Govt. Ex. G-144, p. 3) This was rejected because it would not be economically sound. (Govt. Ex. G-144, p. 9) The negotia-

an investor made an investment when the rental receipts were insufficient to cover operating expenses and full mortgage payments. (Govt. Ex. G-144, pp. 2, 3)

tions were terminated on September 19, 1988. The Assistant Secretary for Housing/FHA Commissioner, Thomas Demery, praised the parties for their efforts and cooperation. (R. Ex. XX, p. 37)<sup>31</sup>

Mr. Darby continued to manage and maintain the Bay Tree and Oakfield properties throughout this period. James Nistler, the former Deputy Assistant Secretary for Single Family Housing, testified that these properties were found by HUD to be the "best" built, maintained, and managed. (Tr. pp. 533, 534)

In October 1988, Mr. Garvin and Mr. Darby offered to tender deeds in lieu of foreclosure on the Bay Tree, Oakfield and Parkbrook properties. (Tr. pp. 536, 841) Ultimately 1600 properties were deeded to HUD for the amount of the outstanding debt, foreclosure actions were dropped, and the "borrowers" released from personal liability on the mortgage notes. (Tr. p. 717) Total claims in the amount of \$6,475,466.22 were paid by HUD for the Bay Tree, Oakfield, and Parkbrook properties. (Tr. p. 340, Govt. Ex. G-155). As of the date of the hearing these properties remained in the HUD inventory. The properties have been maintained by HUD. This has amounted to an additional expense of \$142,023.67. (Tr. p. 341, Govt. Ex. G-155) The present total "loss" on these

<sup>31</sup> The former Deputy Assistant Secretary for Single Family Housing testified on behalf of the Respondent. He had the following to say about the workout attempts:

This particular case, in my opinion—and it got to be a football within my peers as to—if we were a bank and we had this problem, we would have sat down and worked it out. We had talked about the fact that we should admit that we made a mistake in the first place, make it so unique and so different, which it was, that it would never happen again. That was a scenario that went all the way up to the Under Secretary, to do this as a business decision—we made a mistake, let's fix it. At that time, my peers decided (1) it was too late because time had really run and (2) it wasn't the time and place to set a precedent.

(Tr. pp. 539, 540)

properties is \$6,617,489.89. (Govt. Ex. G-155) As these properties should eventually be sold, the actual loss (or profit) is unknown.

A HUD audit of the Mid-South loan transactions was initiated by Mr. Nistler in the Fall of 1986. (Tr. pp. 126, 516-518, Govt. Ex. G-93, p. 3) The purpose of the audit was to discover if there had been any wrongdoing. The audit report concludes that there was no wrongdoing on the part of either Mr. Garvin or Mr. Darby, and that neither the HUD Columbia Office nor HUD Headquarters had been misled.<sup>32</sup> Concerning HUD's knowledge of the Mid-South transactions, the Report states:

From our interviews and reviews of correspondence, we believe that HUD personnel in both Headquarters and the Columbia Office had sufficient knowledge to stop the scheme before or soon after it was initiated. However, they did not.

(Govt. Ex. G-93, p. 2)

HUD subsequently initiated an Inspector General investigation of the Mid-South transactions in 1988. John Coontz, the Deputy Director of Insured Single Family Housing, participated in the investigation, aware that he might testify as an expert witness in any resulting criminal prosecutions. (Tr. p. 294) Mr. Coontz subsequently recommended to the U.S. Attorney that there be criminal prosecutions. (Tr. p. 295) However, prosecution was declined. The prosecutor stated:

The evidence does not show an intent of the part of the applicants or Mid-South Mortgage Company to commit a crime. The intent was to take advantage of a financing situation allowed by HUD officials for projects not feasible for conventional financing.

(R. Ex. NN)

<sup>32</sup> As discussed *supra*, the HUD Columbia Office, did, however, mislead HUD Headquarters.

Mr. Nistler, testified that HUD found no evidence of fraud, deception, deceit or intentional false statements (Tr. pp. 524, 525), or that the program was designed to fail. (Tr. p. 525) He also believed that both HUD offices were sufficiently aware of the relevant facts and approved what was being done.<sup>33</sup>

Mr. Darby has an excellent business reputation in the Charleston community. Until this case, he has never been threatened with sanctions or defaulted on any mortgage loan. (Tr. pp. 841, 842) His character and reputation were strongly vouched for by two witnesses at the hearing. The first, James Walker Coleman, is currently an Executive Vice President of Southern National Bank. (Tr. p. 497) He has thirty-nine years of banking experience and has known Mr. Darby for twenty-five years. Mr. Darby has been loaned millions of dollars by Mr. Coleman's banks. Mr. Coleman also testified that he knew of Mr. Darby's reputation in the community for truth and veracity, honesty and integrity. He stated that "I have absolute confidence in his integrity and his honesty." (Tr. p. 499) The second witness, Joseph C. Reynolds, is a mortgage banker with twenty-three years of mortgage banking experience. (Tr. p. 630) At the present time, he manages mortgage lending for South Carolina Federal Bank. (Tr. p. 631) He served as President of the Mortgage Bankers Association of the Carolinas and was Young Mortgage Banker of the Year in 1982. (Tr. p. 632) He has known Mr. Darby since 1971 and has had weekly, even daily, contact with him since that time. He has loaned Mr. Darby five to seven million dollars involving hundreds of single family loans. Like Mr. Coleman, he is familiar with Mr. Darby's reputation for truth and veracity, honesty and integrity in the community. He testified that his reputation is "well above board".

<sup>33</sup> While the HUD Columbia Office was aware of what had already happened, at the time it wrote to Mr. Abrams, HUD Headquarters was not.

At the time Mr. Nistler left HUD in March 1989, he was unaware of any sanctions being considered against Mr. Garvin or Mr. Darby. By this time, according to Nistler, ". . . we had already statutorily changed the programs to where in fact it couldn't be done again." (Tr. p. 540) The "investor program" for single family mortgages has been eliminated. (Tr. pp. 39, 278). Cash can no longer be "pulled out" of transactions. (Tr. p. 98, Govt. Ex. G-138)

HUD's imposition of an LDP on Mr. Darby was reported in the press. On August 23, 1989, HUD proposed a five year debarment based upon the Bay Tree and Oakfield transactions. Prior to that date, *The State*, a paper in Columbia, carried the headline, "S.C. Mortgage Ripoff is latest HUD Scandal." (R. Ex. DD) On November 16, 1989, the proposal was amended to include the Parkbrook allegations and to lengthen the duration of proposed debarment to an indefinite period.

#### Discussion

The Department has asserted that Respondent's actions with regard to the property transactions constitute grounds for debarment under 24 CFR 24.305(b), (d) and (f), and are adequate evidence to support the LDP under 24 CFR 24.705. Subsection (b) provides that a debarment may be imposed for:

----- [v]iolation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program, such as:

\* \* \* \*

(3) A willful violation of a statutory or regulatory provision or requirement applicable to a public agreement or transaction.

Subsection (d) provides that debarment may be imposed for:

[a]ny other cause of so serious or compelling a nature that it affects the present responsibility of a person.

Subsection (f) provides that a debarment may be imposed for:

material violation of a statutory or regulatory provision or program requirement applicable to a public agreement or transaction including applications for . . . insurance or guarantees, or to the performance of requirements under a . . . final commitment to insure or guarantee.

Section 705(a) of Title 24 of the Code of Federal Regulations lists several causes for LDPs. Among those the enumerated causes are (7) false certification in connection with a HUD program, (8) commission of an offense under Section 24.305, (9) violation of a law or regulation or procedure relating to an application for insurance, and (10) making or procuring false statements for the purpose of influencing an action of the Department.

Based upon the voluminous record in this case, and the findings of fact set forth above, I conclude that despite the complicity of certain components of the Department, the Mid-South financing program used by Respondent was a sham which improperly circumvented the Rule of Seven. False information was provided on the applications for Section 203(b) financing in order to effectuate the sham. By characterizing each transaction as a "refinance" rather than a "sale" on the applications, Respondent was able to avoid the minimum investment requirements of the single family mortgage insurance program. Finally, effectuation of this sham necessarily avoided the requirements of the multifamily mortgage insurance program.

Respondent's acts constitute grounds for an LDP under 24 CFR 24.705(a) (7), (8), (9), and (10) and for de-

barment under CFR 24.305(b), (d) and (f). However, mitigating circumstances militate against imposition of a debarment for an indefinite period.

## I.

Despite the "innovative" nature<sup>34</sup> of the Mid-South financing program, Respondent's use of the program violated a key program requirement of the single family program, the Rule of Seven. From the outset, the intended beneficiary of the financing was Respondent, through Darby Development, MD Investment or the Parkbrook syndicate. Neither Respondent nor these three entities in which he had an interest could apply for financing for more than seven units in their own names because of preclusion by the Rule of Seven. Hence, he used applicants/borrowers who, in their individual capacities, temporarily held title to no more than seven properties at one time and who applied on Respondent's behalf.<sup>35</sup>

<sup>34</sup> According to Respondent, Mr. Garvin's Mid-South financing program, upon which he structured his financial transactions with HUD, was "an innovative financing program" conceived to develop needed rental housing at a time when HUD had reduced its involvement in multifamily housing. (Resp. Brief, pp. 7-8) The program was indeed creative and unusual, but nonetheless, improper. As a matter of fact, the preamble to the Department's waiver regulation discussed *infra* uses the phrase "innovative" to described untested financing proposals of questionable feasibility.

<sup>35</sup> Respondent takes issue with Department's use of the term "strawbuyer". He also contends that the Department has not identified any violation of law, rule, or regulation by the use of the so called strawbuyers. (Resp. Brief, p. 70) Respondent also argues that use of a strawbuyer is cause for debarment only where the "straw-buyer" is used to "hide the real or ultimate title holder." (*Id.* at 71-72) Use of "strawbuyers" was not cause for debarment in this case, according to Respondent, because the persons who signed the applications were not used to "hide from HUD the identities of the real parties in interest or their role or function in the financing program." (*Id.* at 72)

Respondent's argument is specious because the applications were indeed completed in such a way as to "hide", on their face, the

Because of Respondent's sophistication and experience with HUD single family and multifamily programs, he knew or should have known that the Mid-South program violated the Rule of Seven.<sup>36</sup> Respondent's acknowledgment that the proposed mortgage loan transactions "did not quite fit" HUD's application form is further evidence that Respondent knew or should have known that the program was a sham. (Resp. Brief, pp. 74, 75) The applications in their entirety could not be completed accurately to reflect the nature and terms of the transactions. This constituted a "red flag" that use of the single family program as he intended was impermissible.

By violating the Rule of Seven, Respondent contravened the spirit and intent of the single family program. The mass defaults and consequent placement of large numbers of properties insured under the single family program into the HUD inventory which occurred as a result of Respondent's use of the Mid-South financing program was exactly what the Rule of Seven was designed to prevent.

## II.

### Block 9(a)

Effectuation of the sham could only be accomplished by temporary passage of title to the so-called borrowers and the resultant falsification of the applications for single family mortgage insurance. Respondent characterizes the temporary passage of title to and from the applicants/borrowers as a "refinance". This characterization is false

identity of the "real or ultimate title holder". Regardless of what name is attributed to the applicants/borrowers, common sense dictates that their use was fundamentally improper because their involvement was for the sole purpose of obtaining federally insured mortgages, the benefits of which ran to individuals and entities which could not have obtained that mortgage insurance.

<sup>36</sup> Indeed, another builder, on the advice of his attorney, questioned the legality of the Mid-South financing method as a violation of the multifamily rules and regulations. (Tr. pp. 379-80)

for two reasons. First, the transactions constituted, in fact, two separate sales rather than one refinance. Second, an applicant cannot apply in his own name to refinance a construction loan on behalf of another. Thus, Block 9(a) should have been completed to reflect that purchases occurred.

Respondent views the two "transfers" as one overall transaction, i.e., the "complete financing program".<sup>37</sup> (Resp. Brief, p. 79) In reality, however, there were in fact two distinct transactions,<sup>38</sup> each constituting a sale and having its own, yet an identical, legal effect. Throughout this proceeding, Respondent has identified the trans-

<sup>37</sup> In the Amended Answer to the Amended Complaint at 8, Respondent stated that "beneficial ownership" was "vested in" either Respondent, his corporation, or partnership "at all relevant times" and that "legal title" was "temporarily held" by other persons to comply with the Rule of Seven. Respondent did not identify the theory for this "beneficial ownership" and "temporary" holding of "legal title". This argument was not pursued beyond the Answer, and there is no evidence to support it. Even if "equitable title" were vested in Respondent, his corporation or partnership, the applications were completed by the "legal title" holder. As discussed below, the applications therefore should have reflected the method by which the "legal title" holder obtained his/her interest in the property. Sale, rather than refinance, was that method.

Moreover, Respondent's use of both the "legal/equitable title" theory and the "transfer" concept advanced in the brief to describe and justify the "temporary" passage of title to Respondent, Mr. Garvin or the Mid-South employee is a creative, but inaccurate, description of the transactions and demonstrates his recognition that he had to establish some legal relationship between the applicant and the property. It further demonstrates his grappling to describe the legal effect of the transactions as anything but sales.

<sup>38</sup> For the Bay Tree and Oakfield developments, there were two distinct transfers of title: from Respondent's wholly-owned corporation to himself, Mr. Garvin, or a Mid-South employee and back to that corporation. For Parkbrook Acres, there were also two distinct transfers, namely, a transfer of title from Respondent's corporation to the Mid-South employee, and one from the employee to the syndicate.

actions, which were represented by deeds, as "transfers" which were the effective means by which title was passed. "Transfer", however, is a generic term having no independent legal significance. Only specific types of transfers may operate to pass title.

An individual may acquire property only by one of the methods prescribed by law. 73 C.J.S. *Property* Sec. 32 (1983). Those methods are "descent, that is hereditary succession, and "purchase", that is, acquisition obtained by way of bargain and sale, for money, or some other valuable consideration, or other than by descent. J. W. Ehrlich, *Ehrlich's Blackstone* 244, 266 (1959); see also 5 Thompson on Real Property Sec. 2395 at 191 (1979 Replacement Vol.). Since descent is not involved in this case, the acquisitions had to have been by purchase. "Purchase" includes five methods of acquiring title: escheat, occupancy, prescription, forfeiture and alienation. *Ehrlich's Blackstone*, *supra*, at 268. Obviously, the transfer of title in this case was accomplished by alienation. This is the conveyance or purchase of property in its limited sense, i.e., any method whereby property is voluntarily resigned by one person and accepted by another, whether "effected by sale, gift, marriage settlement, devise, or other transmission of property by the mutual consent of the parties." *Id.* at 295. Regardless of the method employed, the transfer must be properly evidenced in order to prevent disputes as to the existence and terms of the transfer. *Id.* at 300. The legal evidences in this case were deeds. *Id.*

Respondent argues that the "transfers involved parties that had a complete and common identity of interest, i.e., to complete a permanent financing transaction which had been disclosed to and approved by HUD." (Resp. Brief, p. 79) However, an individual cannot transfer title to property for the sole purpose of "completing" a financing transaction without employing one of the above-described legal methods for passing title. In this

case, the legal evidences of the "transfers" were identical deeds which specifically state that the properties were sold<sup>39</sup> for consideration of five dollars. The deeds contain specific language of bargain and sale and are valid on their face.<sup>40</sup> Under South Carolina law, where a deed is valid and regular on its face, it is presumed to be valid in all respects. *Davis v. Monteith*, 345 S.E. 2d 724, 727 (S.C. 1986). Thus, both sets of transfers were accomplished by sale.

Respondent's argument that the "transfers" to his corporation or to the syndicate were not sales ignores the legal effect of the deeds of sale. Upon signing the deeds, the legal rights of the parties changed. The "borrowers", however temporary their status, became legally obligated on the notes and owned the property in fee simple. Similarly, the subsequent transfer of the properties again changed the rights of the parties.<sup>41</sup>

<sup>39</sup> For the Bay Tree properties that were the subject of the seven applications signed by Respondent, there were two sets of deeds of sale transferring title—from his corporation to himself, and back to his corporation. Even assuming the construction loans for those seven properties were taken out by Respondent and not his corporation, Respondent's statement that the purpose of the loans was "refinance" was also incorrect because the "transfers" were sales, identical to the sales involving Mr. Garvin and the Mid-South employees.

<sup>40</sup> Rather than relying on the language of the deeds in addressing the sale/refinance issue, the Department relies on the principle that an applicant cannot refinance another person's debt. Essentially, the Department argues that the purpose of the loans was "sale" because it was not "refinance". To argue that the transactions were not refinances, however, begs the question. The conclusion reached in this decision is based on the express language of the deeds and the proper legal characterization of the transactions themselves.

<sup>41</sup> Respondent argues that the second set of "transfers" from Respondent and the Mid-South employees to his corporation or the syndicate were not sales because, *inter alia*, there was no arms-length dealing or "consideration paid or received". (Resp. Brief, p. 79) In fact, the second set of deeds recites the same consideration as the first set. If the second set of "transfers" were not sales, the

Respondent's additional argument that an applicant could refinance another person's loan is specious. As a general matter, refinance means to "finance again or anew." Black's Law Dictionary, 5th Ed., 1979, at 1152. The Department correctly argues that "[o]bviously, one cannot finance for a second time that which one has yet to finance for the first time." (Govt. Brief, p. 23) Moreover, if Respondent's argument were correct and it were permissible for an applicant to apply for a mortgage on behalf of another person, HUD would have no way of assuring that the "true" applicant satisfied all the requirements for issuing insurance, including a demonstrated ability to repay.

Although the transaction was structured in such a way that title passed to the "borrower" prior to closing, the transaction was nonetheless a sale and Block 9(a) incorrectly stated that the purpose of the loan was a "refinance". Due to the unique and artificial nature of the financing program, whether title passed at or before the closing is irrelevant to the description the "applicant" should have given to the purpose of the loan. Thus, the purpose that should have been stated on the application was the purchase of property.<sup>42</sup>

first set could not have been sales and title would never have passed to the temporary purchasers in the first place.

Moreover, under South Carolina law, mere inadequacy of consideration will not justify cancellation of a deed absent fraud or undue influence. *Atkinson v. Belser*, 255 S.E. 2d 852, 855 (S.C. 1979). Respondent does not assert, nor is there evidence, that fraud or the exercise of undue influence was involved and therefore there is no evidence supporting cancellation of the deeds.

<sup>42</sup> In Block 9 (a), there are several sub-blocks relating to "purchase". For the Bay Tree and Oakfield properties, the applicants/mortgagors should have checked sub-block 6 "purchase existing home not previously occupied". For the Parkbrook properties, the applicants/mortgagors should have checked sub-box 7 "construct a home—proceeds to be paid out during construction", which implies a "purchase".

Blocks 9(b), 31(a)(1) and 31(a)(3)

Block 9(b) asks the applicant to state his intended relationship to the property. Respondent contends that the "landlord" block was appropriately checked

because it most accurately described the *end result* of the mortgage loan transaction,—i.e., the owner/borrower would own and operate the property as investor-owner who would indeed be a landlord and thus the FHA-insured loan was to finance a rental property.

(*Resp's Brief*, p. 77) (Emphasis added)

Respondent's argument, however, does not focus on the appropriate person's "end result". In order to have any meaning and to be reliable, the form must correctly identify what the *applicant's* relationship to the property will be, not some unnamed entity. It is undisputed that the "applicants" did not intend to be landlords of these properties. Indeed, because Block 33 requires the signature of the "borrower" and was signed by either Respondent, Mr. Garvin, or a Mid-South employee, Respondent cannot argue that the term "borrower" used in Box 9(b) referred to anyone other than the person signing the form, the "applicant". The fact that there was an oral disclosure to certain HUD employees of the intended landlord (Respondent's corporation or syndicate) does not make the written statement true. Furthermore, the written statement could not be relied upon by anyone not aware of the actual facts surrounding the transaction.

Moreover, Respondent chose which person's "end result" (the applicant or the ultimate owner) applied to suit his purposes. This resulted in the answers given in Blocks 9(a), (b) and Block 31(a)(1) (which answers "no" to the question of whether the property was owned or sold within the last 12 months is to be sold) that were inconsistent with the answers to Block 31(a)(3) (which asks whether the property was part of, adjacent to or

contiguous to any properties involving eight or more units). The first set of blocks was answered as if the ultimate owners were the relevant subjects. The second set, however, was answered as if the temporary purchasers were the relevant subjects. Respondent cannot have it both ways. Had the applicants answered Block 31(a)(3) consistently with Blocks 9(a), 9(b) and 31(a)(1), the applications would have contained unmistakable violations of the Rule of Seven, and they would not have been approved.

The answers to these blocks were false. Therefore, Respondent submitted and caused others to submit false statements on the Section 203 applications.<sup>43</sup> The false statements enabled Respondent to obtain financing to which he was not entitled. Respondent asserts that the Department did not rely upon the statements because Mr. Garvin made a sufficient disclosure. Although the ma-

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<sup>43</sup> Respondent argues that a Section 203 applicant does not certify his answers to Sections I, which includes Blocks 9(a) and 9(b), but rather certifies the accuracy of the personal and financial information in Section II (relating to the disclosure of an applicant's assets and liabilities). (*Resp. Brief*, pp. 75-76) In that regard, Respondent further argues that "HUD loan processors have the responsibility of checking and, if necessary, correcting the accuracy of the information provided in the applications." (*Id.* at 76). Whether or not HUD is responsible for verification of the information is irrelevant; the applicant is in the first instance responsible for submitting accurate information. It defies logic to argue that simply because of the absence of a certification which expressly applies to particular information, an applicant may ever submit false information on a government form in order to obtain benefits.

Further, as Respondent fails to note, Section V, Block 33 contains the directions: "[b]efore signing, review accuracy of application and certifications". That direction applies to all the statements made by the "borrower" in the application. Moreover, following Block 33, the application form sets forth in bold print the warning that, inter alia, any "intentional misrepresentation . . . purposed to influence the issuance of any . . . insurance by . . . HUD . . ." violates federal laws which provide severe penalties.

terial facts were disclosed to isolated HUD employees and, therefore, there was no evidence of fraud, the statements were indeed false and were known to be false. Had the applications not been completed in this manner, HUD Columbia could not have approved the applications, including its calculation of the mortgage amount based on the stated purpose of the loan.

### III.

Because the transactions were sales, Respondent was required, but failed, to satisfy the minimum investment requirements. By identifying the purpose of the loan on the HUD forms as a "refinance", Respondent was entitled to borrow more money than he would have if he had identified it as a "purchase" and obtained a cash surplus from the mortgage amounts.

### IV.

Debarment is a sanction which may be invoked by HUD as a measure for protecting the public by ensuring that only those qualified as "responsible" are allowed to participate in HUD programs; *Stanko Packing Co. v. Bergland*, 489 F. Supp. 947, 949 (D.D.C. 1980); *Roemer v. Hoffman*, 419 F. Supp. 130, 131 (D.D.C. 1976). "Responsibility" is a term of art used in government contract law. It encompasses the projected business risk of a person doing business with HUD. This includes his integrity, honesty, and ability to perform. The primary test for debarment is present responsibility although a finding of present lack of responsibility can be based upon past acts. *Schlesinger v. Gates*, 249 F.2d 111 (D.C. Cir. 1957); *Roemer, supra*. The debarment sanction may also be justified on the basis of its deterrent effect on those who do business with the government.

The Department proved by preponderant evidence that there are grounds for debarment under 24 CFR 305(b),

(d) and (f).<sup>44</sup> Respondent placed extensive public funds at risk when he knowingly used the sham financing program. Further, in connection with making false statements on the applications, he demonstrated a lack of forthrightness in his dealings with the government. The Department has, therefore, established by preponderant evidence that Respondent lacks present responsibility. In addition, debarment will serve to deter both him and others from taking similar actions.

Specifically, Respondent willfully and materially violated statutory and regulatory provisions and program requirements and he may therefore be debarred under 24 CFR 305(b) and (f). In using the Mid-South financing program, Respondent knowingly violated the HUD regulation setting forth the single family program's Rule of Seven. Respondent also knowingly avoided the procedures and requirements applicable to the multifamily program. He also knowingly violated the single family program's minimum investment requirements.

Respondent's actions are also cause for debarment under 24 CFR 305(d). That subsection, which concerns present responsibility, is broad enough to include the making of false statements on applications for FHA insurance.<sup>45</sup> Those falsities were the means by which the sham financing program was effectuated.

<sup>44</sup> This finding subsumes a finding for imposition of the LDP under the basic evidentiary standard of "adequate evidence". See 24 CFR 24.705(a)(8).

<sup>45</sup> Respondent relies on the HUD Board of Contract Appeals' Determination in *Wayne C. Sellers*, HUDBCA No. 88-1295-DB (LDP) and 88-1305-DB (Aug. 2, 1989). This Determination interpreted subsection (d)'s enumeration of specific grounds for debarment as limiting the application of that subsection to those grounds. Accordingly, Respondent contends that subsection (d) does not apply because "Respondent's conduct does not even remotely fit within the enumerated causes. . . ." (Resp. Brief, p. 75 n.4) That Determination, however, was reversed by the Secretary's designee on October 31, 1989. The Secretary's designee found that applicability of subsection (d) is not limited to causes similar to those enumerated in that subsection.

Once the applications were falsified, they failed to reflect the true nature of the transactions. Thus, anyone not knowing the actual facts would be unable rely upon them. The Department and the public must be able to rely upon the accuracy of the written representations made to it. It is impermissible for one doing business with the government to provide accurate information orally to isolated government employees regarding a transaction, and misinformation regarding the same transaction in a writing held out to the government and the public.

The Department failed to prove by preponderant evidence, however, that Respondent's defaults are grounds for debarment. The Department argues that Respondent allowed the HUD insured mortgages to default because he thought that the Department would not attempt to collect any deficiencies. (Govt. Brief, p. 65) It further relies upon Respondent's success in avoiding foreclosure of his conventionally financed properties.<sup>46</sup> As discussed below this contention is without merit because Respondent made good-faith efforts to negotiate a work-out with HUD to avoid foreclosure.<sup>47</sup>

## VI.

Respondent argues that the government should be estopped from debaring him because of the doctrine of equitable estoppel. Estoppel is an equitable doctrine in-

<sup>46</sup> The Department also argues that the \$6000 which Respondent spent on plane fare in order to negotiate a work-out would have been more appropriately applied to the mortgage indebtedness. (Govt. Brief, p. 65) The Department's argument is counterproductive; it would discourage individuals from making good-faith attempts to avoid foreclosure and make good on their debts.

<sup>47</sup> The Department argues that "the real reason for Respondent's eagerness for his attempt to obtain a work-out was not for the Department's benefit but to avoid tax losses on depreciation and to protect the interests of the limited partners in the Parkbrook syndication." (Govt. Brief, p. 66) Even if true, however, this would not denigrate his good-faith efforts to obtain a work-out.

voked to avoid injustice in particular cases. *Heckler v. Community Health Services*, 467 U.S. 51 (1984), *reh'g denied*, 475 U.S. 1061 (1986). In *Heckler*, the Court left open the question of whether estoppel can ever be applied against the government. This question, however, need not be reached. For the reasons below, this case does not present a situation where application of the doctrine is appropriate.

The doctrine of equitable estoppel is applied against any party, whether private or the government, only when the following traditional elements are present.<sup>48</sup>

If one person makes a definite misrepresentation of fact to another person having reason to believe that the other will rely upon it and the other in reasonable reliance upon it does an act that would not constitute a tort if the misrepresentation were true, the first person is not entitled . . . to maintain an action of tort<sup>(49)</sup> against the other for the act. . . .

Restatement, Torts, 2d Sec. 894(1) (1979). To be reasonable, the party claiming estoppel must not have known, nor should it have known, that the government's conduct was misleading. *Heckler*, 467 U.S. at 59.

<sup>48</sup> The Court in *Heckler* stated that "the Government may not be estopped on the same terms as any other litigant." 467 U.S. at 60-61. Some courts, including the Fourth Circuit, have held that, assuming the government may be estopped in an appropriate case, the private party must, at a minimum, also establish that the government engaged in some "affirmative misconduct". See, e.g., *Zogrofav v. V.A. Medical Center*, 779 F.2d 967, 969-70 (4th Cir. 1985). Because, as discussed below, Respondent failed to establish the traditional elements of estoppel, the issue of whether HUD's conduct in this case constituted affirmative misconduct need not be reached.

<sup>49</sup> Although the LDP and proposed debarment are not tort actions, they are analogous in that they attempt to correct a wrong committed against the party bringing the action.

Respondent's reliance on the representations<sup>50</sup> made by HUD<sup>51</sup> regarding the permissibility of the Mid-South financing program was unreasonable.<sup>52</sup> As stated, above, because of Respondent's sophistication and experience in HUD's single family and multifamily programs, he knew or should have known that the financing program violated the spirit and intent of the single family program, including the Rule of Seven and the minimum investment requirements. Under those circumstances, Respondent cannot hide behind the fact that government employees approved the program when he, in the first instance, knew or should have known that it was improper.

As stated in *Heckler* at 63,

Protection of the public fisc requires that those who seek public funds act with scrupulous regard for the requirements of law; respondent could expect no less than to be held to the most demanding standards in

<sup>50</sup> Mr. Granat and Mr. DesChamps of the HUD Columbia Office and Ms. Ruth Studer of HUD Headquarters Single Family Division, Mortgage Credit Section were the HUD personnel who represented to Mr. Garvin that the Mid-South financing program was permissible. Although initially these persons were told neither that the original owners of the properties would ultimately obtain the properties back through other entities in which they also had interests nor that the transactions would be characterized as "refinances," Messrs. Granat and DesChamps and Ms. Studer knew enough about the program from the other information made available to them that they should have not given their imprimatur to the program.

<sup>51</sup> Respondent's reliance upon representations that HUD employees had approved the Mid-South program was not based upon any direct contact he had with these employees. It was based on Mr. Garvin's assurances that the financing program met with HUD's approval and HUD Columbia Office approval of the applications submitted by Mr. Garvin.

<sup>52</sup> The Department also argues that Respondent is not entitled to equitable estoppel because his "hands are far from clean." (Govt. Brief, p. 46) Because I find that Respondent's reliance was unreasonable, it is unnecessary to apply the doctrine of unclean hands in this case. Moreover, I need not decide whether Respondent demonstrated the other elements of estoppel.

its quest for public funds. This is consistent with the general rule that those who deal with the Government are expected to know the law and may not rely on the conduct of Government agents contrary to law.

Before using the "innovative" financing program which was intended to avoid a key program requirement and which placed a great deal of public funds at risk,<sup>53</sup> Respondent should have prepared a written proposal for review and received a written confirmation prepared on or on behalf of the Secretary or Assistant Secretary for Housing. As noted by the Court in *Heckler*, the requirement of a writing serves two purposes: to avoid fraud and to foster well-reasoned decisionmaking subject to the possibility of review. 467 U.S. at 65. Any reasonable and prudent businessman in Respondent's shoes would have obtained appropriate written approval prior to using the program. Reliance upon oral advice from the local office or from a staff employee at Headquarters on an issue of this complexity was anything but reasonable.<sup>54</sup> As in *Heckler*, both Respondent's failure to obtain written approval and his failure to do so from the appropriate source undermined Respondent's reliance.<sup>55</sup>

<sup>53</sup> This was accomplished because Respondent not only received public funds, but also subjected those funds to speculative market forces, including the assumption of an eventual lowering of interest rates and continued high inflation.

<sup>54</sup> Ms. Studer, the Headquarters employee who responded that the financing program was permissible, was only one of two staff employees in HUD Headquarters responsible for answering questions from the field relating to the single family program. Because the financing program did not satisfy the Rule of Seven, Ms. Studer, as well as anyone in the HUD Columbia Office, lacked the authority to approve the financing program. Thus, the unreasonableness of Respondent's reliance is further demonstrated by the fact that insofar as the misrepresentations were made by HUD, they were not made by an authorized official.

<sup>55</sup> As the minimum investment requirement is mandated by statute, Respondent could not have obtained an exception from that

Regulatory changes concerning waivers of eligibility requirements underscore the unreasonableness of Respondent's reliance. Since October 6, 1982, there has been in effect a regulation expressly providing for waivers of eligibility requirements under the single family program. 47 Fed. Reg. 35957 (Aug. 18, 1982). Section 203.248 of Title 24 of the Code of Federal Regulations provides that

The Secretary in an individual case may waive any requirement of this subpart (except [sections] 203.1 through 203.9) not required by statute if the Secretary finds that application of such requirement would adversely affect achievement of the purposes of the Act. Each such waiver shall be *in writing* and supported by a statement of the facts and grounds forming the basis for the waiver. The authority under this section may be delegated to the Assistant Secretary for Housing—Federal Housing Commissioner, but shall not be redelegated.

(Emphasis added)

On April 6, 1982, HUD published this regulation as a proposed rule in the Federal Register. The proposed rule was identical to the final rule, which was published on August 18, 1982. See 47 Fed. Reg. 35957. In the preamble to the final rule, the Department noted that

[i]n adopting this final rule, HUD intends that the new waiver procedure be available in individual cases to prevent undue hardship to homebuyers resulting from new or changed market conditions; to test the feasibility of an innovative financing proposal; or to solve a unique housing problem. . . . HUD emphasizes that its waiver authority is not intended to be utilized for "end runs" around the rule-making process. Waivers will be considered only in

requirement. Basing his conduct upon representations that he could do so further underscores the unreasonableness of his reliance.

special circumstances and will be granted only in limited cases. . . .

*Id.* at 35957-58.

This regulation was not in effect when Mr. Garvin first approached the HUD Columbia Office with his financing program proposal. However, Respondent submitted applications at various times pursuant to the Mid-South financing program: (1) after the proposed rule was published for notice and comment but before publication of the final rule; (2) after the final rule was published, but not yet effective; and (3) after the effective date of the regulation.

While Respondent is not being held responsible for a failure to utilize the waiver regulation, he knew or should have known of its publication as a proposed and final rule and taken appropriate action. When the proposed rule was first published, he was on notice that the Department was considering the procedures for obtaining exemptions from regulatory requirements where an "innovative financing proposal" was involved. Those procedures included written action at the Secretarial level. It is contrary to an assertion of reasonable reliance that Respondent failed to write to Headquarters to ascertain the ramifications the new regulation would have on his use of the financing program.

It should be noted that the Department is far from blameless for its part in the events which led to formulation and implementation of the Mid-South financing program. The Department's complicity is evident. It began with the HUD Columbia Office's approval of the financing program, including its having based that approval on the advice of a Headquarters employee rather than a high-level official and the inexplicable failure by the head of that office to take timely action regarding that program. It continued through the Columbia Office's disre-

gard of the memorandum from Headquarters advising of the impropriety of the program.

Mr. Garvin explained the program in sufficient detail that Messrs. DesChamps and Granat and Ms. Studer should have recognized that the program violated the Rule of Seven. Mr. Corley knew that the program was being used and went so far as to tell another builder that Headquarters approved of its use. Mr. Corley either did not inquire as to the exact source and medium of that approval or was told that it was oral approval from a staff employee and viewed that as sufficient. As discussed *infra*, the HUD Columbia Office, if for no other reason than self-protection, should have sought written approval from appropriate high-level officials at Headquarters.

Despite the fact that the HUD Columbia Office had been receiving applications from Mid-South in bulk by the bus-load, that the employee responsible for processing the applications was "keeping score" to make sure no applicant owner more than seven properties, and that Mr. Garvin was corresponding with HUD requesting "substitution" of applicants, it was not until after the Director of Housing and Mr. Granat went out into the field that they became concerned. Even then, they were concerned with the extent to which the program had been implemented rather than the nature of the financing program itself.

Perhaps most troubling is that Mr. Corley should have, but did not, order his employees to hold in abeyance any applications submitted pursuant to the Mid-South financing program pending appropriate Headquarters' action. Instead, he belatedly requested guidance and advice from the appropriate official at Headquarters concerning the "proposed" financing program. That request was misleading, and demonstrated the HUD Columbia's Office's attempt to hide the fact that it had been approving applications submitted pursuant to the Mid-South financing

program all along. The failure to acknowledge that the program had already been implemented was only exacerbated by Mr. Corley's staff's continued issuance of final commitments where conditional commitments had been issued despite having been advised that the "proposed" program was impermissible.

## VII.

HUD regulations provide that "[t]he existence of a cause for debarment . . . does not necessarily require that the person be debarred; the seriousness of the person's acts or omissions and any mitigating factors shall be considered in making any debarment decision. 24 CFR 24.300.<sup>50</sup> Respondent's acts were serious because they placed at risk a large number of properties and a great deal of public funds. Further, through use of the Mid-South financing program, Respondent caused others to submit false statements on official government documents on his behalf.

Despite the seriousness of Respondent's acts, however, mitigating factors exist which weigh against imposition of an indefinite debarment as requested by the Department. While use of the Mid-South financing program was improper and involved making false statements on the applications, there is no evidence of any intent to deceive the Department; most of the relevant facts were indeed disclosed to the HUD Columbia Office and a Headquarters employee. Thus, in obtaining mortgage insurance through the wrong program, Respondent did not defraud the government. Indeed, the United States Attorney declined criminal prosecution of Respondent because of lack of intent to commit a crime. The only intent the prosecutor found was "to take advantage of a financing situation allowed by HUD officials for projects

<sup>50</sup> Similarly, the HUD regulations regarding LDPs provide that "[i]n each case . . . the decision to order a limited denial of participation shall be discretionary and in the best interests of the Government." 24 CFR 24.700.

not feasible for conventional financing." The lack of criminal intent, including an intent to defraud the government, militates against a period of debarment for 3 years or more. Under the circumstances, such a debarment would serve no legitimate purpose and, therefore, would be punitive.

Respondent did not conceive the Mid-South financing program: he simply saw and took advantage of a "good thing" that was already working for Mr. Garvin. Moreover, the program was not designed to fail; Respondent did not partake of the program to cheat the government out of money. Although Respondent was able to "pull out" excess mortgage proceeds, his corporation and the syndicate covered substantial operating deficits for several years, which essentially had the effect of "subsidizing" the rental property. Unfortunately for Respondent, his and Mr. Garvin's market assumptions were not realized. This prevented Respondent from ultimately selling the properties as single family housing and led to the defaults.

Most importantly, the extent to which Respondent genuinely cooperated with HUD to try work out his financial dilemma and avoid foreclosure weighs very heavily in his favor. His efforts in this regard were herculean and beyond reproach; between 1986 and 1988, Respondent negotiated with HUD over a possible work-out. (Tr. p. 834) He traveled to Washington, D.C. many times during that period and spent thousands of dollars in air fare. (Tr. p. 835) It was the Respondent who contacted HUD before the defaults occurred to discuss the problems and who went to extraordinary efforts to save the properties involved. In fact, the former Assistant Secretary for Housing/FHA Commissioner praised Respondent for his efforts and cooperation in exploring various alternatives to foreclosure. (R. Ex. XX, p. 37)

Respondent's cooperation in this regard is only further enhanced by the undisputed evidence of his reputation

for truth and veracity among reputable lenders in the community and of his exemplary performance as a builder and manager of housing projects. Until his defaults in this case, Respondent had never defaulted on any properties in his 28 years in the real estate business. Further, Respondent convincingly testified that:

this thing has been one of the most traumatic experiences in my life, it's ruined my reputation. It was in the paper, newspapers. . . . Of greatest significance . . . is I can't do any more business with HUD.

(Tr. p. 842) Thus, Respondent appeared to genuinely regret the situation in which he placed himself.

Another factor which weighs in favor of mitigation is the passage of time. Respondent's acts at issue took place in 1982 and 1983; the LDP was issued and debarment proposed in 1989. By the time those actions were taken, the programs had been changed by statute to eliminate the "investor program" for single family mortgages.

Nonetheless, a debarment for a meaningful period is necessary to deter Respondent and others from acting similarly in the future. As a seasoned businessman well-versed in the single family and multifamily housing programs, Respondent knew or should have known that the financing program was improper. He should have taken the necessary measures to obtain appropriate Department clearance on his own behalf.

As stated by Justice Holmes in *Rock Island, A. & L. R. Co. v. United States*, 254 U.S. 141, 143 (1920), "[m]en must turn square corners when they deal with the Government." Although Respondent's personal honesty and integrity have not been implicated in his use of the financing program, by blindly following Mr. Garvin's financing program, his exercise of prudent business judgment has been called into question. A debarment of some

length is warranted to impress upon Respondent that he must act prudently when dealing with the government and to send a message to those who deal with the government that they, too, must act prudently in similar circumstances.

I find that Respondent should be debarred for a period of 18 months, beginning on June 19, 1989, the date on which the LDP was imposed. A debarment for 18 months is a serious sanction, commensurate with the seriousness of his acts. In light of the mitigating circumstances discussed above, however, a greater debarment period would be punitive.

#### Conclusion and Order

Upon consideration of the entire record in this matter, I conclude that the Limited Denial of Participation of Robert Gordon Darby is supported by adequate evidence. I also conclude that its duration of 1 year is appropriate to protect the public fisc and is in the public interest.

Upon consideration of the public interest and the entire record in this matter, I conclude that good cause exists to debar Ronald Gordon Darby, and his affiliates, Darby Development Company, Inc., Darby Realty Company, Darby Management Company, Inc., MD Investment, Parkbrook Acres Associates and Parkbrook Developers, from further participation in primary covered transactions and lower tier covered transactions as either participants or principals at HUD and throughout the Executive Branch of the Federal Government and from participating in procurement contracts with HUD for a period of 18 months to run from June 19, 1989, the date of his limited denial of participation, to and including December 19, 1990.

/s/ William C. Cregar  
WILLIAM C. CREGAR  
Administrative Law Judge

Dated: April 13, 1990

#### APPENDIX E

#### ADMINISTRATIVE PROCEEDING IN THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

---

IN THE MATTER OF  
ROBERT GORDON DARBY  
DARBY DEVELOPMENT CO., INC.  
DARBY REALTY CO.  
DARBY MANAGEMENT CO., INC.  
MD INVESTMENT  
PARKBROOK ACRES ASSOCIATES  
PARKBROOK DEVELOPERS

---

#### FINAL DETERMINATION

By letter dated August 23, 1989, Robert Gordon Darby was notified by certified mail that his debarment was being proposed based on causes under Title 24, Code of Federal Regulations, Sections 24.305(b), (d) and (f).

By an order dated April 13, 1990, Administrative Law Judge William C. Cregar issued a determination of debarment against Robert Gordon Darby and his affiliates for a period of 18 months from the date of a Limited Denial of Participation, June 19, 1989, to and including December 19, 1990.

Pursuant to the provisions of 24 CFR, Section 24.314 (g) this final determination imposes the debarment, cited above, and excludes Mr. Darby and his affiliates, Darby Development Co., Inc.; Darby Realty Co.; Darby Management Co., Inc.; MD Investment; Parkbrook Acres Associates; and Parkbrook Developers, from participation in covered transactions (see 24 CFR, Section 110(a))

(1)) at HUD and throughout the Executive Branch of the Federal Government and from participation in procurement contracts with HUD.

This determination shall have no bearing on future Departmental actions, if any, which may be based on facts not considered in this case.

Sincerely yours,

C. AUSTIN FITTS  
Assistant Secretary for  
Housing-Federal Housing  
Commissioner

Dated Jun. 21, 1990

Washington, D.C.

cc:

G. Richard Dunnells, Esq.  
Steven D. Gordon, Esq.  
Dunnells, Duvall, Bennett  
and Porter  
2100 Pennsylvania Ave., N.W.  
Suite 400  
Washington, D.C. 20037

# APPENDIX F

## UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 91-2113

R. GORDON DARBY; DARBY DEVELOPMENT COMPANY;  
DARBY REALTY COMPANY; DARBY MANAGEMENT COM-  
PANY, INCORPORATED; MD INVESTMENT; PARKBROOK  
ACRES ASSOCIATES; PARKBROOK DEVELOPERS,  
*Plaintiffs-Appellees*

v.

JACK KEMP, SECRETARY OF HOUSING AND URBAN DEVEL-  
OPMENT; C. AUSTIN FITTS, Assistant Secretary for  
Housing/FHA Commissioner; UNITED STATES OF  
AMERICA,  
*Defendants-Appellants*

On Petition for Rehearing with  
Suggestion for Rehearing In Banc

[Filed March 20, 1992]

The appellees filed a petition for rehearing with sug-  
gestion for rehearing in banc. No member of the Court  
requested a poll on the suggestion for rehearing in banc,  
and the original judicial panel voted to deny the petition  
for rehearing.

The Court denies the petition for rehearing with sug-  
gestion for rehearing in banc.

Entered at the direction of Judge Wilkins, with the  
concurrence of Judge Phillips and Judge Ward.

For the Court,

/s/ John M. Greacen  
Clerk

AUG 19 1992

No. 91-2045

OFFICE OF THE CLERK

**In the Supreme Court of the United States**

OCTOBER TERM, 1992

---

**R. GORDON DARBY, ET AL., PETITIONERS***v.***JACK KEMP, SECRETARY OF HOUSING AND URBAN  
DEVELOPMENT, ET AL.**

---

**ON PETITION FOR A WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT**

---

**BRIEF FOR THE RESPONDENTS IN OPPOSITION**

---

**KENNETH W. STARR**  
*Solicitor General***STUART M. GERSON**  
*Assistant Attorney General***ANTHONY J. STEINMEYER****LORI M. BERANEK***Attorneys**Department of Justice  
Washington, D.C. 20530**(202) 514-2217***RECEIVED**

AUG 20 1992

OFFICE OF THE CLERK  
SUPREME COURT, U.S.

4 f  
**QUESTION PRESENTED**

Whether petitioners were required to exhaust their administrative remedies before seeking judicial review of sanctions recommended by a hearing officer of the Department of Housing and Urban Development.

(I)

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## In the Supreme Court of the United States

OCTOBER TERM, 1992

---

No. 91-2045

R. GORDON DARBY, ET AL., PETITIONERS

*v.*

JACK KEMP, SECRETARY OF HOUSING AND URBAN  
DEVELOPMENT, ET AL.

---

ON PETITION FOR A WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT

---

BRIEF FOR THE RESPONDENTS IN OPPOSITION

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is reported at 957 F.2d 145. The orders of the district court (Pet. App. 8a-32a) are unreported.

### JURISDICTION

The judgment of the court of appeals was entered on February 26, 1992. A petition for rehearing was denied on March 20, 1992. Pet. App. 93a. The petition for a writ of certiorari was filed on June 18, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. Petitioners, R. Gordon Darby and several real estate development companies that he owned or controlled, made use of a single-family mortgage insurance program offered by the United States Department of Housing and Urban Development (HUD) to finance multi-family housing projects in South Carolina. Among other things, petitioners' financing methods evaded HUD's minimum investment requirements as well as a limitation on the number of mortgages issued to a single borrower for contiguous housing units. Pet. App. 2a.

HUD conducted an investigation and concluded that petitioners' financing method violated HUD regulations. On June 19, 1989, HUD issued a Limited Denial of Participation (LDP) that prohibited petitioners from taking part in certain HUD housing programs in South Carolina for one year. On August 23, 1989, HUD proposed that petitioners be debarred from participating in most Executive Branch programs for five years.<sup>1</sup> Upon learning that petitioner had used the same financing method to obtain permanent financing for other housing developments, HUD proposed that petitioners be debarred indefinitely. Pet. App. 2a.

Petitioners challenged the LDP and the debarment before an Administrative Law Judge. On April 13, 1990, after a four-day hearing, the ALJ issued an initial decision and order that upheld the LDP but reduced the indefinite debarment to a period of 18

<sup>1</sup> A person who is debarred may not act as a participant or principal in any "primary covered transactions" and "lower tiered covered transactions" with the Executive Branch of the federal government for the period of the debarment. 24 C.F.R. 24.200(a) and (b).

months. Neither petitioners nor the Assistant Secretary of Housing sought agency review of this decision.<sup>2</sup>

2. Petitioners brought this action in district court seeking a declaration that the LDP and debarment violated the Administrative Procedure Act, 5 U.S.C. 551-559, 701-706, and the Due Process Clause of the Fifth Amendment.<sup>3</sup> The government moved to dismiss the action on the ground that petitioners had failed to exhaust their administrative remedies. The district court denied the motion. The court concluded that the applicable regulation does not explicitly require exhaustion. In addition, the court ruled that requiring petitioners to exhaust administrative remedies would have been futile, that available administrative remedies were insufficient, and that requiring exhaustion would have shielded the ALJ's decision from judicial scrutiny. On the merits, the district court reversed the ALJ's decision imposing an 18-month debarment. Pet. App. 8a-19a, 20a-32a.

<sup>2</sup> HUD regulations provide that

[t]he hearing officer's determination shall be final unless, pursuant to 24 CFR Part 26, the Secretary or the Secretary's designee, within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer. The 30 day period for deciding whether to review a determination may be extended upon written notice of such extension by the Secretary or his designee. Any party may request such a review in writing within 15 days of receipt of the hearing officer's determination.

24 C.F.R. 24.314(c). See also 24 C.F.R. 26.25(a) (setting out requirements for a petition for review).

<sup>3</sup> One month after this suit was filed, HUD issued a final determination restating the terms of petitioners' debarment as specified in the ALJ's order. Pet. App. 91a-92a. See 24 C.F.R. 24.314(g).

3. The court of appeals reversed. Pet. App. 1a-7a. The court relied on the "long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Id.* at 4a (quoting *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938)). The court recognized that "[t]he rule of exhaustion is \* \* \*, 'like most judicial doctrines, subject to numerous exceptions.'" Pet. App. 4a (quoting *McKart v. United States*, 395 U.S. 185, 193 (1969)). For example, exhaustion is not required if administrative review would be futile, administrative remedies are inadequate, or requiring exhaustion would leave the administrative decision unreviewed. Pet. App. 5a (citing cases).

The court concluded that petitioners had not shown that any of these exceptions to the exhaustion requirement applied in this case. Although petitioners asserted that further administrative review would have been futile because "the upper echelons of HUD had endorsed debarment," the court found no indication in the record that HUD had "taken a hard and fast position that [made] an adverse ruling a certainty." Pet. App. 5a (quoting *Thetford Properties IV Ltd. Partnership v. HUD*, 907 F.2d 445, 450 (4th Cir. 1990)). In addition, the court rejected petitioners' argument that administrative remedies were inadequate because the Secretary is permitted to extend the time within which to issue an administrative decision. The court concluded that the time limitations imposed by regulation were adequate in the absence of a showing that the Secretary has failed, or will fail, to act within a reasonable period of time." Pet. App. 6a. Finally, the court rejected petitioners' argument that requiring exhaustion would preclude judicial review. Petitioners, "by strategic decision or other-

wise," allowed the 15-day period for requesting agency review of the ALJ's decision to expire. *Ibid.* Consequently, petitioners cannot complain that the exhaustion requirement makes the ALJ's decision unreviewable. Pet. App. 7a.

### ARGUMENT

The Court "long has acknowledged the general rule that parties exhaust prescribed administrative remedies before seeking relief from the federal courts." *McCarthy v. Madigan*, 112 S. Ct. 1081, 1086 (1992) (citing *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938)). Exhaustion "serves the twin purposes of protecting administrative agency authority and promoting judicial efficiency." *McCarthy*, 112 S. Ct. at 1086. The exhaustion requirement is particularly appropriate "when the action under review involves exercise of the agency's discretionary power or when the agency proceedings in question allow the agency to apply its special expertise." *Ibid.* (citing *McKart v. United States*, 395 U.S. 185, 194 (1969); *Bowen v. City of New York*, 476 U.S. 467, 484 (1986)). Allowing the agency an opportunity to correct its own errors reduces the volume of cases in the judicial system and results in a more complete administrative record. *McCarthy*, 112 S. Ct. at 1086-1087.

Congressional intent is "[o]f 'paramount importance' to any exhaustion inquiry." *McCarthy*, 112 S. Ct. at 1086 (quoting *Patsy v. Board of Regents*, 457 U.S. 496, 501 (1982)). If Congress "specifically mandates, exhaustion is required." *McCarthy*, 112 S. Ct. at 1086. See *Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561, 579 (1989). "But where Congress has not clearly required exhaustion, sound judicial discretion governs." *McCarthy*, 112 S. Ct. at 1086; see *McGee v. United States*, 402 U.S. 479, 483 n.6

(1971). "In determining whether exhaustion is required, federal courts must balance the interest of the individual in retaining prompt access to a federal judicial forum against countervailing institutional interests favoring exhaustion." *McCarthy*, 112 S. Ct. at 1087. That "intensely practical" inquiry requires attention "to both the nature of the claim presented and the characteristics of the particular administrative procedure provided." *Ibid.* (quoting *Bowen v. City of New York*, 476 U.S. 467, 484 (1986)).

Contrary to petitioners' assertion (Pet. 8), the court of appeals did not "create[] a novel and insupportable 'rule of judicial administration' that any possible administrative appeal must be exhausted." Instead, the court of appeals merely applied settled legal principles and concluded, as a matter of "sound judicial discretion," that petitioners were required to exhaust their administrative remedies.

Petitioners do not challenge the court of appeals' determination that the institutional interests advanced by requiring exhaustion in this case outweigh petitioners' interest in obtaining immediate access to the federal courts. Instead, they advance the radical argument that courts have no discretion to determine whether exhaustion of administrative remedies is required, because Section 10(c) of the Administrative Procedure Act, 5 U.S.C. 704, allegedly provides that exhaustion is never required unless a statute or regulation specifically provides otherwise. Petitioners' contention is unpersuasive.

Section 704 provides:

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly review-

able is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsiderations, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

By its terms, Section 704 provides only that a "final agency action" is "subject to judicial review." The statute does not provide that such actions are always subject to immediate judicial review, without regard to established doctrines such as exhaustion of administrative remedies that "govern the timing of federal court decisionmaking." *McCarthy*, 112 S. Ct. at 1086. Accordingly, the courts of appeals that have considered the issue have recognized that Section 704 governs the jurisdictional issue of finality, not whether exhaustion should be required as a matter of sound judicial administration. See *Missouri v. Bowen*, 813 F.2d 864, 870-871 (8th Cir. 1987); *Montgomery v. Rumsfeld*, 572 F.2d 250, 253 n.3 (9th Cir. 1978); *Steere Tank Lines, Inc. v. ICC*, 675 F.2d 763, 766-767 (5th Cir. 1982). Indeed, if exhaustion of administrative remedies were a jurisdictional prerequisite, the courts could not exercise jurisdiction in cases in which exhaustion would be futile or administrative remedies are inadequate.<sup>4</sup>

<sup>4</sup> Petitioners' reliance on the legislative history of Section 704 is also unconvincing. The Attorney General's analysis of Section 704 stated that the provision was "intended to state existing law." S. Doc. No. 248, 79th Cong., 2d Sess. 369 (1946). Prior to the enactment of the APA, it was established that an

There is no force to petitioners' contention that the court of appeals' decision conflicts with this Court's decision in *ICC v. Brotherhood of Locomotive Engineers*, 482 U.S. 270 (1987). In that case, the Court held that a timely petition for administrative reconsideration "render[s] the orders under reconsideration nonfinal," and therefore extends the 60-day period within which a party may petition for judicial review of an administrative order under the Hobbs Act, 28 U.S.C. 2341 *et seq.* 482 U.S. at 284-285. In the course of its discussion, the Court stated that 5 U.S.C. 704 "relieve[s] parties from the requirement of petitioning for rehearing before seeking judicial review (unless, of course, specifically required to do so by statute)." 482 U.S. at 284-285. The Court's statement that a petition for rehearing is not necessary to render an administrative order "final" within the meaning of Section 704 does not imply that courts have no discretion to require exhaustion of administrative remedies as a prerequisite to judicial review. Indeed, if petitioners' expansive reading of Section 704 were correct, the Court's lengthy exhaustion analysis in leading cases such as *McKart v. United States*, 395 U.S. 185 (1969), and *McGee v. United States*, 402 U.S. 479 (1971), was superfluous.

Petitioners are also off the mark in contending that the decision in this case conflicts with decisions of other courts of appeals. The decisions cited by petitioner are consistent with the framework of analysis established by this Court's decisions and applied by the court of appeals in this case. In each case, the court examined the relevant statutes to determine

administrative appeal was a prerequisite to judicial review. See *Chicago, M., St. P. & P. R.R. v. Risty*, 276 U.S. 567 (1928); *United States v. Sing Tuck*, 194 U.S. 161 (1904).

Congress's intent, and applied the judicial doctrine of exhaustion where no such intent could be discerned. See *Steere Tank Lines, Inc. v. ICC*, 675 F.2d 763, 766 (5th Cir. 1982) ("administrative scheme devised by Congress, and used by the ICC \* \* \* clearly requires" exhaustion); *Gulf Oil Corp. v. Department of Energy*, 663 F.2d 296, 307-309 (D.C. Cir. 1981) (statute does not explicitly require exhaustion, and "time-honored purposes of exhaustion" not applicable); *New England Coalition v. Nuclear Regulatory Comm'n*, 582 F.2d 87, 99 (1st Cir. 1978) (relevant regulations provided, and agency conceded, that exhaustion was not required). Accordingly, no further review is warranted.<sup>5</sup>

#### CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR  
Solicitor General

STUART M. GERSON  
Assistant Attorney General

ANTHONY J. STEINMEYER  
LORI M. BERANEK  
Attorneys

AUGUST 1992

<sup>5</sup> Contrary to petitioners' contention (Pet. 4), HUD regulations provide that the ALJ's decision is inoperative pending review by the Secretary. The ALJ's decision is "final unless a party timely appeals the decision and \* \* \* the Secretary decides to review the determination." 24 C.F.R. 26.24(f). "During such period, the hearing officer's determination is not final and, therefore, has no immediate effect." 48 Fed. Reg. 43,304 (1983).

3  
No. 91-2045

Supreme Court, U.S.  
FILED

DEC 17 1992

OFFICE OF THE CLERK

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1992

R. GORDON DARBY, *et al.*,  
*Petitioners,*

v.

JACK KEMP, *et al.*,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Fourth Circuit

JOINT APPENDIX

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The following opinions, decisions, judgments, and orders have been omitted in printing this joint appendix because they appear on the following pages in the appendix to the printed Petition for Certiorari:

Initial Decision and Order of the Administrative Law Judge, United States Department of Housing and Urban Development ("HUD"), dated April 13, 1990 .....	33a
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Order of the United States District Court for the District of South Carolina denying defendant Kemp's motion to dismiss, and denying plaintiff Darby's motion for preliminary injunction, entered October 29, 1990 .....	20a
Order of the United States District Court for the District of South Carolina granting plaintiff Darby's motion for summary judgment, entered April 10, 1991 .....	8a
Opinion of the Court of Appeals for the Fourth Circuit, dated February 26, 1992 .....	1a

**CHRONOLOGICAL LIST OF  
RELEVANT DOCKET ENTRIES**

May 31, 1990—Plaintiff Darby's complaint filed in U.S. District Court for the District of South Carolina, Charleston Division.

May 31, 1990—Plaintiff's motion for preliminary injunction filed.

July 2, 1990—Defendant Kemp's motion to dismiss for failure to exhaust administrative remedies filed.

September 13, 1990—Hearing on defendant's motion to dismiss and plaintiff's motion for preliminary injunction.

September 27, 1990—Plaintiff's motion for summary judgment filed.

October 17, 1990—Defendant Kemp's cross motion for summary judgment filed.

October 29, 1990—Order entered denying defendant's motion to dismiss and denying plaintiff's motion for preliminary injunction.

November 9, 1990—Defendant's answer filed.

December 18, 1990—Hearing on cross motions for summary judgment.

April 10, 1991—Order entered granting plaintiff's motion for summary judgment and denying defendant's motion for summary judgment.

June 4, 1991—Defendant's notice of appeal filed.

February 26, 1992—Opinion and judgment of the Court of Appeals for the Fourth Circuit.

March 11, 1992—Appellee Darby's petition for rehearing, with suggestion for rehearing in banc, filed.

March 20, 1992—Order entered denying petition for rehearing and suggestion for rehearing in banc.

UNITED STATES DISTRICT COURT  
FOR DISTRICT OF SOUTH CAROLINA

Civil Action No. 2-90-1184-18

R. GORDON DARBY, DARBY DEVELOPMENT COMPANY,  
DARBY REALTY COMPANY, DARBY MANAGEMENT COM-  
PANY, INC., MD INVESTMENT, PARKBROOK ACRES  
ASSOCIATES, and PARKBROOK DEVELOPERS,  
*Plaintiffs,*

v.

HONORABLE JACK KEMP, Secretary of U.S. Department  
of Housing and Urban Development, 451 7th Street,  
S.W., Room No. 10000, Washington, D.C. 20410,

C. AUSTIN FITTS, Assistant Secretary for Housing/FHA,  
Commissioner, 451 7th Street, S.W., Room No. 9100,  
Washington, D.C. 20410,

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,  
451 7th Street, S.W., Room No. 10266, Washington,  
D.C. 20410,

and

THE UNITED STATES OF AMERICA,  
*Defendants.*

COMPLAINT FOR DECLARATORY AND  
INJUNCTIVE RELIEF

[Filed May 31, 1990]

PRELIMINARY STATEMENT

1. This action, seeking injunctive and declaratory relief from defendants' unlawful debarment of plaintiffs, arises under the Due Process Clause of the Fifth Amend-

ment to the United States Constitution and under the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551 *et seq.*, and §§ 701, *et seq.* The Department of Housing and Urban Development ("HUD") has sanctioned plaintiff R. Gordon Darby with a one-year Limited Denial of Participation ("LDP") and has debarred Mr. Darby and his affiliate companies and partnerships for 18 months based on Mr. Darby's actions during 1982-1983 in participating in a HUD-insured financing program that was used extensively in South Carolina with the knowledge and approval of HUD.

2. HUD imposed these sanctions notwithstanding the conclusions of its own Administrative Law Judge ("ALJ") that (a) Mr. Darby, who has spent 28 years in the real estate business, enjoys an excellent reputation for truth and veracity and has consistently demonstrated "exemplary performance as a builder and manager of housing projects"; (b) the financing program in issue was not designed to fail; (c) Mr. Darby did not participate in the program to cheat the government out of money; and (d) although HUD mortgage insurance was obtained through the wrong program, there was no intent to deceive HUD, and Mr. Darby did not defraud HUD. Moreover, HUD purports to sanction Mr. Darby as an irresponsible government contractor despite undisputed evidence that the financing program it now finds to have been improper was contemporaneously disclosed to and approved by HUD, itself.

3. In sanctioning the plaintiffs under these circumstances, defendants committed the following violations of the Constitution, the APA, and HUD's own regulations, 24 C.F.R. Part 24, which require that the LDP and the debarments be set aside:

a. Defendants' conclusions that Mr. Darby engaged in misconduct are not supported by substantial evidence

in the record, and are otherwise arbitrary, capricious, and not in accordance with law.

b. Defendants erroneously concluded that HUD was not estopped from sanctioning plaintiffs based on its prior approval of the financing program which Mr. Darby utilized, thereby violating plaintiff's constitutional right to due process of law and his statutory rights under the APA.

c. Defendants acted in an arbitrary and capricious manner by debarring plaintiffs yet failing to similarly sanction their own officials who approved plaintiffs' conduct.

d. Defendants' conclusion that Mr. Darby engaged in misconduct by failing to exercise "prudent business judgment" on two occasions in 1982 and 1983, even if correct, does not rationally support a conclusion that he lacks present responsibility as a government contractor in light of the undisputed evidence of his integrity, his "exemplary performance as a builder and manager of housing projects," and the fact that the alleged misconduct in 1982-1983 is now incapable of repetition.

e. Defendants' rationale for debarring plaintiffs—to deter Mr. Darby and others from acting similarly in the future—is contrary to law because it constitutes forbidden punishment of a contractor for perceived past misdeeds rather than protecting the government from a contractor who is not presently responsible.

4. Plaintiff seeks entry of a judgment setting aside the LDP and debarments and declaring such actions to have been taken in violation of the Fifth Amendment guarantee of due process and to have been arbitrary, capricious, unsupported by substantial evidence, an abuse of discretion and not in accordance with law, in violation of the APA. Plaintiff also seeks entry of appropriate preliminary and permanent injunctions to redress the

continuing irreparable injury he is suffering from defendants' unlawful actions.

## PARTIES

5. Plaintiff R. Gordon Darby resides in Charleston, South Carolina.

6. Plaintiffs Darby Development Company, Inc., Darby Realty Company, Darby Management Company, Inc., MD Investment, Parkbrook Acres Associates, and Parkbrook Developers are all companies or partnerships owned by R. Gordon Darby or in which he has an interest, and all are "affiliates" of Mr. Darby within the meaning of 24 C.F.R. § 24.105 and 24.325.

7. Defendant Kemp is the Secretary of the Department of Housing and Urban Development and is sued in his official capacity.

8. Defendant Fitts is the Assistant Secretary for Housing and FHA Commissioner for the Department of Housing and Urban Development, and is sued in her official capacity.

9. Defendant United States issued the debarment through defendant Department of Housing and Urban Development, located in Washington, D.C.

## JURISDICTION

10. This Court has jurisdiction of this action under 28 U.S.C. §§ 1331, 1346, and 2201. Venue in this case is based on 28 U.S.C. § 1391(e).

11. This action arises under the Due Process Clause of the Fifth Amendment of the Constitution, the Administrative Procedure Act (APA), as amended, 5 U.S.C. §§ 551, *et seq.*, and 701, *et seq.*, and the Office of the Secretary, Housing and Urban Development debarment regulations, 24 C.F.R. Part 24.

## PROCEDURAL HISTORY

12. HUD issued a one-year LDP against Mr. Darby on June 19, 1989. Following an administrative conference regarding this sanction, HUD affirmed the LDP by letter dated July 11, 1989. Mr. Darby appealed the LDP on July 21, 1989 (HUDALJ 89-1373-DB (LDP)).

13. Thereafter, by notice dated August 23, 1989, HUD proposed to debar all plaintiffs—Mr. Darby and his affiliates—for a period of five years, based on the same underlying facts and circumstances that gave rise to the LDP. On August 28, 1989, HUD filed a formal Complaint seeking plaintiffs' debarment. (HUDALJ 89-1387-DB). Plaintiffs timely requested a hearing and filed an Answer on October 20, 1989. By letter dated November 16, 1989, HUD amended its Complaint and sought to increase the length of the proposed debarment to an indefinite period.

14. The LDP appeal and the debarment action were consolidated for hearing. A four-day evidentiary hearing was conducted before HUD Administrative Law Judge ("ALJ") William Cregar on December 19-22, 1989, in Charleston, South Carolina. That hearing was transcribed and a transcript has been prepared.

15. Following the hearing, both parties filed briefs and the ALJ took the case under advisement. On April 13, 1990, the ALJ issued a written "Initial Decision and Order" [the "HUD Decision"] upholding the LDP and concluding that good cause exists to debar plaintiffs for a period of 18 months. The ALJ concluded that the LDP and debarment were warranted because of Mr. Darby's actions during 1982-1983 in participating in the HUD single family mortgage loan program. The other plaintiffs were debarred based solely on their status as affiliates of Mr. Darby. A copy of the HUD Decision is attached hereto as Exhibit 1. The hearing transcript, exhibits, pleadings, and the HUD Decision form the administrative record in this case.

16. No discretionary review of the ALJ's decision and order was sought from defendant Kemp by either party. Accordingly, the ALJ's decision and order became final on April 29, 1990, and plaintiffs have exhausted their administrative remedies.

## FACTUAL AVERMENTS

### A. *The Mid-South Financing Program*

17. The financing program that HUD has now found improper was not originated by Mr. Darby, but instead was devised by a mortgage banker and recognized expert in HUD financing, Lonnie Garvin, Jr., who was then the President of Mid-South Mortgage Company ("Mid-South"), an FHA-approved mortgage then located in Aiken, South Carolina.

18. Mr. Garvin's plan was devised during 1981 in an environment of high inflation and high interest rates that had drastically slowed new housing construction and produced a pent-up demand for rental housing in South Carolina. Mr. Garvin's plan was to utilize HUD's single family mortgage insurance program to build units that would initially be marketed as rental housing and later, when interest rates dropped, could be sold off as single family units. Mr. Garvin recognized that, during the initial years, there would be a negative cash flow on the units because rents could not be set high enough to cover the debt service. Accordingly, the plan envisioned that the units would be owned by limited partnerships, which would cover the operating deficits in return for tax write-offs for the limited partner investors, and which would eventually make a profit when economic conditions turned more favorable and permitted the units to be sold off or refinanced.

19. Mr. Garvin's plan envisioned the use of HUD-insured mortgage loans obtained pursuant to the single family mortgage insurance program, section 203(b) of

the National Housing Act, 12 U.S.C. § 1709(b), to provide permanent financing on the housing units. The HUD-insured mortgage loans would be used to refinance or "take out" the short-term construction loans utilized to build the housing units. Indeed, Mr. Garvin would not obtain construction financing and commence building the units until he had a commitment from HUD to insure the permanent mortgage loans upon the completion of construction.

20. Mr. Garvin perceived that the major issue he faced in trying to structure this financing program was the so-called Rule of Seven, a HUD regulation which made rental properties ineligible for single family insurance if the mortgagor already had financial interests in seven or more, similar rental properties in the same project or subdivision. 24 C.F.R. § 203.42(a). The project that Mr. Garvin envisioned building would consist of 30 units.

21. Accordingly, in mid-1981, Mr. Garvin went to the HUD field office in Columbia, South Carolina, to outline his plan and obtain HUD's interpretation of the Rule of Seven. Mr. Garvin spoke to two senior HUD officials who were in charge of administering the single family program in South Carolina, Henry Granat, Deputy Director for Housing Development, and Robert DesChamps, Chief of the Mortgage Credit Branch. Mr. Garvin was advised by these HUD officials that the Rule of Seven would be satisfied if the units in the project were divided up so that any one borrower had an interest in no more than seven units at the time of loan closing.

22. Relying on the interpretation of the Rule of Seven provided to him by HUD, Mr. Garvin refined his financing plan and took the other steps necessary to prepare for the project he sought to build, a development named Plantation Ridge. He secured options on building lots, and submitted construction plans and specifications to the HUD Columbia office for approval. After applications for the HUD mortgage insurance were prepared, Mr.

Garvin met again with Messrs. Granat and DesChamps in November 1981. Mr. Garvin explained that (a) he was proposing the construction of a project consisting of more than seven units; (b) in order to comply with the Rule of Seven, the applications for the mortgage loans and the HUD insurance thereon would be made in the names of various Mid-South employees, each of whom would hold title to no more than seven properties; and (c) following the closing of the mortgage loans and the issuance of the HUD mortgage insurance, title to the properties would be transferred to a single limited partnership which would rent the properties and cover the operating deficits.

23. Mr. DesChamps, at the direction of Mr. Granat and in the presence of Mr. Garvin, called HUD headquarters in Washington, D.C. for advice regarding the acceptability of Mr. Garvin's plan. He spoke with Ruth Studer, a recognized expert in issues regarding the single family mortgage credit programs, and the national "point person" for questions from HUD field offices regarding the application of the Rule of Seven. Mr. DesChamps described the proposed transaction to Ms. Studer. She advised Mr. DesChamps that Mr. Garvin's financing arrangement would not violate HUD program requirements.

24. The applications for mortgage insurance submitted by the Mid-South employees regarding the Plantation Ridge project indicated in Block 9(a) that the purpose of the mortgage loans was "refinance" because the loans were to be used as permanent financing to replace the construction loans actually used to build the project. This answer and all other answers provided on the applications were fair and reasonable, and made honestly and in good faith.

25. Because the mortgage loans were refinance transactions, the so-called "minimum investment requirement," 24 C.F.R. § 203.19, did not apply in determining the maximum permissible loan amount. Instead, the loan

amounts were based on appraisals of the properties performed by HUD appraisers as part of the HUD approval process and were limited by a separate regulation that set essentially the same ceilings as the minimum investment requirement. HUD Handbook 4000.2 Rev-1, ¶¶ 2-6, 2-7, 2-11 (April 1982).

26. Fully aware of Mr. Garvin's financing plan and the role to be played by the Mid-South employees, HUD approved the Plantation Ridge applications and issued insurance on the mortgage loans for that project.

27. Subsequently Mr. Garvin used this same financing approach for other housing projects he developed—obtaining HUD-insured single family mortgage loans to refinance construction loans on the projects, and satisfying the Rule of Seven by dividing up the housing units in the project for purposes of obtaining the insured loans, following which the units were consolidated in a single owner ("the Mid-South financing program"). Between 1981 and 1984, Mid-South processed approximately 1050 applications through the HUD Columbia office and developed over 1600 housing units using this same financing approach. Most of these applications were processed by Charles Bennett, a HUD employee who worked under the supervision of Mr. DesChamps. There was no attempt by Mid-South to conceal either the nature or the number of these transactions. Indeed, Mr. Bennett kept track of the transfers of title to and from the various Mid-South employees who served as the mortgage insurance applicants, in order to ensure that no one applicant held title to more than seven properties at a time.

#### B. *The Darby Transactions.*

28. Mr. Darby was involved in utilizing the Mid-South financing program on only two occasions, both of which occurred in the latter half of 1982, approximately a year after Mr. Garvin had instituted the program. In utilizing the Mid-South approach, Mr. Darby reasonably

relied upon the assurance of Mr. Garvin that HUD had approved this financing program, and upon the fact that HUD had already approved over 160 loan transactions that were predicated upon this financing program.

29. One of the two occasions on which Mr. Darby was involved in the use of the Mid-South financing program was with regard to a project named Parkbrook Acres. Mr. Garvin was Mr. Darby's partner in developing this project, and it was he who supervised the development of the project and the securing of the HUD-insured financing. The development, financing, and syndication of Parkbrook Acres followed the pattern Mr. Garvin had initiated with the Plantation Ridge project. Mr. Darby did not prepare any of the mortgage insurance applications relating to the Parkbrook Area project, nor did he serve as the applicant for any of the mortgage loans.

30. The second occasion involving Mr. Darby's participation in the Mid-South financing program related to two projects named Bay Tree and Oakfield. Unlike Parkbrook Acres, these projects had already been constructed and had outstanding construction loans at the time HUD-insured mortgages were sought. Further, Mr. Garvin played no role in the development of these projects. In addition, the Baytree and Oakfield properties were not transferred to a limited partnership after the mortgage loans were closed. Instead, they were transferred to Darby Development Company, which operated them as rental properties. Finally, Mr. Darby personally acted as the loan applicant with respect to seven units on these properties.

31. The mortgage insurance applications submitted to HUD with respect to Parkbrook Acres, Bay Tree, and Oakfield essentially followed the same pattern used on other Mid-South transactions. The answers provided on those applications were fair and reasonable, and made honestly and in good faith.

### C. HUD's Change of Position.

32. The applications relating to Parkbrook Acres, Bay Tree, and Oakfield were duly approved by HUD. The mortgage loans were closed and the mortgages were insured by HUD against default.

33. At some point in early 1983, certain HUD Columbia officials, including Mr. Granat, became concerned about the volume of properties being processed pursuant to the Mid-South financing program. Mr. Granat asked his section chiefs to review the correctness of their approval of the applications and was advised by them that everything was in order. Just to make sure, Mr. DesChamps again contacted Ms. Studer at HUD headquarters on March 30, 1983. Mr. DesChamps explained in detail to Ms. Studer the workings of the Mid-South program, and again was advised that applicable program requirements were being satisfied.

34. In the fall of 1983, the HUD Columbia office again contacted HUD headquarters to review the acceptability of the Mid-South financing program. This contact was done by means of a memorandum dated August 30, 1983, addressed to the Acting Assistant Secretary for Housing. His reply, dated September 23, 1983, stated that the Mid-South program was "unacceptable." This was the first time that any official at HUD had indicated disapproval of the Mid-South financing program. By this time, the HUD-insured mortgage loans for Mr. Darby's projects at Parkbrook Acres, Bay Tree, and Oakfield had long since closed. Upon receipt of this communication, the HUD Columbia office stopped the approval of any new applications but continued to process and insure 53 properties for which it had already issued conditional commitments to Mid-South.

### D. The Defaults and HUD's Response.

35. In 1986, due to market forces beyond the control of Mr. Darby and Mr. Garvin, the mortgage loans secured through the Mid-South financing program went into

default. Over the next two-and-a-half years, Messrs. Darby and Garvin made herculean efforts to work out their financial dilemma with HUD and thereby avoid foreclosure and consequent claims for the mortgage insurance. These efforts were all ultimately rejected by HUD for various reasons. In October 1988, Messrs. Garvin and Darby tendered deeds on the properties to HUD in lieu of foreclosure. HUD, in turn, paid substantial insurance claims to the mortgage holders.

36. Mr. Darby has an excellent business reputation in the Charleston community. Until this case, he has never been threatened with sanctions. Other than the three projects at Parkbrook Acres, Baytree, and Oakfield, he has never defaulted on any mortgage loan. His performance as a builder and manager of housing projects has been exemplary.

37. A HUD audit of the Mid-South loan transactions was initiated in the fall of 1986 and was conducted contemporaneously with the workout negotiations. The purpose of the audit was to discover if there had been any wrongdoing. The audit report concluded that there had been no wrongdoing on the part of either Mr. Garvin or Mr. Darby, and that neither the HUD Columbia office nor HUD headquarters had been misled.

38. Certain individuals in HUD thereafter sought to instigate criminal prosecutions, but the United States Attorney's Office for the District of South Carolina declined to bring any such prosecutions. The United States Attorney's Office concluded that there was no evidence of any intent to commit a crime on the part of the loan applicants or Mid-South. Instead "[t]he intent was to take advantage of a financing situation allowed by HUD officials for projects not feasible for conventional financing." HUD Decision, p. 22.

39. Nonetheless, HUD proceeded unilaterally to impose sanctions on certain selected persons involved in

using or approving the Mid-South financing program. On June 19, 1989, HUD imposed one year LDPs on Mr. Darby, Mr. Garvin, certain former Mid-South employees who had acted as the loan applicants/borrowers, and the four HUD Columbia officials who had been involved in approving the Mid-South loan applications: Messrs. Granat, DesChamps, Franklin Corley, and Bennett (all of whom are now retired from HUD). However, HUD never sought to sanction Ruth Studer, the Washington headquarters employee and national expert on single family mortgage credit programs, who had twice advised HUD Columbia that the Mid-South program was acceptable. Although several of the HUD Columbia employees protested the imposition of LDPs against them, HUD refused to modify any except in the case of Corley, whose LDP was reduced to three months.

40. Following the imposition of the LDP sanctions, the South Carolina press reported extensively on the Mid-South loan origination cases. One Columbia newspaper, the State, carried an editorial during the week of August 14, 1989, headlined: "S.C. MORTGAGE RIPOFF IS LATEST HUD SCANDAL." Noting that HUD had imposed LDP sanctions against Mr. Garvin and fourteen others, the article stated, "[b]ut the punishment—a prohibition against doing HUD-related business in this state for a year—is hardly more than a tap on the wrist. HUD officials in Washington can—and should—extend the sanctions nationwide for up to ten years." The HUD Regional Office in Atlanta received this editorial and shortly thereafter, on August 23, 1989, HUD proposed the debarment of Mr. Darby for a period of five years. Subsequently, HUD sought to extend the term of the proposed debarment was increased to an indefinite period. HUD likewise sought the indefinite debarment of Mr. Garvin. (That matter is still pending before the ALJ and is currently scheduled for hearing on August 13, 1990). HUD has not, however, sought to debar any of its own employees.

41. Congress and HUD have since changed the single family mortgage insurance program to eliminate any participation by investors. Thus, the Mid-South financing program could not be replicated today under any circumstances.

#### E. *The HUD Decision.*

42. In upholding the LDP of Mr. Darby and deciding to debar plaintiffs, the ALJ concluded that the Mid-South financing program was a sham which improperly circumvented the Rule of Seven. He further concluded that false statements had been made on the mortgage insurance applications in order to effectuate the sham. In particular, he concluded that the transactions were falsely characterized as "refinances," thereby permitting the evasion of the minimum investment requirements. HUD Decision, p. 24.

43. Insofar as Mr. Darby was concerned, the ALJ concluded that, notwithstanding HUD's approval of the Mid-South financing program, Mr. Darby "knew or should have known that it was improper." HUD Decision, pp. 25, 32. Although Mr. Darby did not intend to deceive or defraud HUD and although his personal honesty and integrity were not implicated in his use of the Mid-South financing program, the ALJ concluded that, "by blindly following Mr. Garvin's financing program, [Mr. Darby's] exercise of prudent business judgment has been called into question." HUD Decision, p. 37. The ALJ's ultimate conclusion was that "[a] debarment of some length is warranted to impress upon [Mr. Darby] that he must act prudently when dealing with the government and to send a message to those who deal with the government that they, too, must act prudently in similar circumstances." *Id.*

44. The ALJ rejected plaintiffs' defense that HUD was estopped from imposing sanctions because HUD had approved the Mid-South financing program. The ALJ ruled

that Mr. Darby's reliance on the representations made by HUD regarding the permissibility of the Mid-South program was unreasonable. Mr. Darby, the ALJ held, "cannot hide behind the fact that government employees approved the program when he, in the first instance, knew or should have known that it was improper." HUD Decision, p. 32.

*F. The Injury Suffered by Plaintiffs.*

45. The debarments preclude plaintiffs from receiving or participating in government contracts and from participating in any HUD programs. Under its terms, government agencies are prohibited from soliciting bids or proposals from, awarding contracts to, renewing or otherwise extending existing contracts, or consenting to subcontracts with plaintiffs, unless the acquiring agency's head or designee determines that there is a compelling reason for such action. Plaintiffs are also excluded from doing business with the government as an agent or representative of other contractors. Plaintiffs' debarment is effective throughout the Executive Branch of the United States Government and results in plaintiffs' inclusion on the "List of Parties Excluded From Procurement and Non-Procurement Programs."

46. The LDP imposed on Mr. Darby and the debarments imposed on all of the plaintiffs have caused and will cause them substantial and irreparable injury for which there is no adequate remedy at law. These sanctions unfairly and unlawfully stigmatize and punish plaintiffs, cause economic injury to plaintiffs, and deprive plaintiffs of their constitutionally-protected liberty interest in remaining eligible to contract with the government.

47. Seventy-five percent of the business income of Mr. Darby and Darby Development Company derives from government contracts or programs. These plaintiffs have already been deprived of the opportunity to receive award of one large contract by the issuance of the LDP in June

1989 and thereby suffered the loss of over \$500,000 of income. In addition, Darby Development Company (of which Mr. Darby is the sole owner) has property management contracts on five different HUD-insured multifamily properties that expire during the course of 1990 and would otherwise be renewed. HUD will not allow these contracts to be renewed until after the debarment period expires in December 1990, thus depriving plaintiffs of \$92,280 in management fees that would otherwise have been earned. Plaintiffs also face the loss of \$25,875 in Housing Assistance payments under a Section 8 HUD contract that expires in September 1990 and which would otherwise be renewed but for the debarment.

COUNT I

Violation of the APA—Legally Erroneous  
Conclusion that Plaintiffs Committed Misconduct

48. Plaintiffs incorporate the allegations of paragraphs 1 through 47 as if set forth fully herein.

49. HUD's conclusion that Mr. Darby knew or should have known that the Mid-South financing program was improper is devoid of support, both factually and legally. HUD's conclusion that false statements were made on the mortgage insurance applications is likewise devoid of support. Further, since the loan transactions were properly characterized as "refinances," the minimum investment requirements were not applicable and there is no basis for faulting Mr. Darby for not complying with those requirements.

50. HUD's legal conclusion that Mr. Darby willfully and materially violated statutory and regulatory provisions and program requirements is not supported by substantial evidence in the record, and is otherwise arbitrary, capricious, and not in accordance with law. The LDP and debarment imposed on Mr. Darby by defendants are therefore contrary to law.

51. Since the other plaintiffs were barred solely on their status as affiliates of Mr. Darby, their debarments likewise are contrary to law.

### COUNT II

#### Constitutional Violation—Defendants' Imposition of Sanctions Against Plaintiffs Deprives Them of Due Process of Law

52. Plaintiff hereby incorporates the allegations of paragraphs 1 through 51 as if set forth fully herein.

53. On the facts presented in this case, the constitutional guarantee of Due Process prevents HUD from sanctioning plaintiffs for conduct which it had previously approved. The sanctions deprive plaintiffs of protected liberty interests in violation of their rights under the Fifth Amendment to the Constitution.

### COUNT III

#### Violation of the APA—Defendants' Erroneous Rejection of Plaintiffs' Estoppel Defense

54. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 53 as if set forth fully herein.

55. HUD's legal conclusion that it was not estopped from sanctioning plaintiffs because Mr. Darby could not reasonably have relied on HUD's approval of the Mid-South financing program is not supported by substantial evidence in the record, and is otherwise arbitrary, capricious and not in accordance with law. The LDP and debarment imposed on Mr. Darby by defendants are therefore contrary to law.

56. Since the other plaintiffs were debarred based solely on their status as affiliates of Mr. Darby, their debarments likewise are contrary to law.

### COUNT IV

#### Violation of the APA—Arbitrary And Unlawful Sanctioning of Plaintiffs

57. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 56 as if set forth fully herein.

58. Defendants acted in an arbitrary and capricious manner by debarring plaintiffs yet failing to similarly sanction their own officials who approved plaintiffs' conduct and had even greater reason to know whether it was permissible under applicable regulatory provisions. Therefore, the debarments imposed upon plaintiffs by defendants are arbitrary and capricious, in violation of the APA.

### COUNT V

#### Violation of the APA—Arbitrary and Irrational Conclusion That Plaintiffs Are Not Presently Responsible Government Contractors

59. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 58 as if set forth fully herein.

60. Defendants' conclusion that Mr. Darby engaged in misconduct by failing to exercise "prudent business judgment" on two occasions in 1982 and 1983, even if correct, does not rationally support a conclusion that he and his affiliates are not presently responsible government contractors or program participants in light of the minimal culpability involved in the misconduct, the substantial passage of time since those alleged lapses, Mr. Darby's excellent business reputation, his exemplary record of performance as a builder and manager of housing projects, and the fact that there is no danger whatsoever of the alleged misconduct being repeated. Therefore, the sanctions imposed upon plaintiffs by defendants are arbitrary and capricious, and contrary to law.

## COUNT VI

Violation of the APA—Unlawful Debarment of  
Plaintiffs For Purposes of Deterrence

61. Plaintiffs hereby incorporate the allegations of paragraphs 1 through 60 as if set forth fully herein.

62. HUD's debarment regulations forbid imposing debarment for purposes of punishment and permit debarment only for the purpose of protecting the public interest. 24 C.F.R. § 24.115.

63. Defendants' rationale for debarring plaintiffs—to deter Mr. Darby and others from engaging in similar conduct in the future—ignores Mr. Darby's present responsibility as a government contractor and program participant and amounts to punishment for perceived past misdeeds in violation of HUD's own regulation. Accordingly, the debarment of plaintiffs is arbitrary, capricious, and contrary to law.

WHEREFORE, plaintiffs respectfully request entry of a judgment or other form of order:

A. Setting aside the LDP imposed on Mr. Darby and the debarments imposed on all plaintiffs;

B. Declaring the LDP and debarments to have been contrary to law, and to have violated plaintiffs' rights under the Fifth Amendment to the United States Constitution and under the APA;

C. Directing defendants not to place plaintiffs' names on, or in the alternative, to remove plaintiffs' names forthwith from, all compilations of those ineligible to participate in HUD programs or receive an award of government contracts, including, but not limited to, the "List of Parties Excluded From Procurement and Non-Procurement Programs";

D. Granting preliminary and permanent injunctive relief enjoining defendants from taking any action to ex-

clude plaintiffs from government contracting or any HUD programs based upon Mr. Darby's participation in the Mid-South financing program in 1982 and 1983;

E. Awarding plaintiffs their costs, disbursements and reasonable attorneys fees in this action; and

G. Granting such other relief as is just and proper.

Respectfully submitted,

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DATED: May 31, 1990

EXHIBIT 1  
INITIAL DECISION AND ORDER

(Issued by the ALJ on April 13, 1990)

[The "Initial Decision and Order" has already been filed in the case as Appendix D to the "Petition for a Writ of Certiorari."]

IN THE DISTRICT COURT OF UNITED STATES  
FOR DISTRICT OF SOUTH CAROLINA  
CHARLESTON DIVISION

Civil Action No. 2-90-1184-18

R. GORDON DARBY, *et al.*,  
*Plaintiffs*

v.

HONORABLE JACK KEMP, *et al.*,  
*Defendants.*

GOVERNMENT'S ANSWER TO PLAINTIFFS  
COMPLAINT FOR DECLARATORY AND  
INJUNCTIVE RELIEF

The Defendants herein respectfully submit their answer to Plaintiffs' Complaint in the above-captioned case, calling to the attention of the Court and incorporating herein by reference the April 13, 1990 Decision and Order by Administrative Law Judge William C. Cregar and Defendants' Memorandum in Support of Defendants' Motion for Summary Judgment and Response to Plaintiffs' Motion for Summary Judgment filed with the Court October 17, 1990, as follows:

1. The first sentence of paragraph 1 of Plaintiffs' Complaint is a conclusion of law to which an answer is not required; to the extent an answer is required, it is denied. As to the second sentence, Defendants deny that the financing "program" or scheme employed by Plaintiffs was used with Defendants' knowledge or approval, but admit the remaining averments of the sentence.

2. The first sentence of paragraph 2 is denied insofar as it implies there were insufficient facts to support the

decision of the Administrative Law Judge. The second sentence is also denied, insofar as it alleges the Mid-South financing plan was disclosed to and approved by HUD.

3. Denied.

4. Denied.

5. Admitted.

6. Admitted.

7. Admitted.

8. Admitted.

9. Admitted.

10. The allegations of paragraph 10 are conclusions of law to which an answer is not required; to the extent an answer is required, the allegations are denied.

11. Denied.

12. Admitted.

13. Admitted.

14. Admitted.

15. Admitted.

16. The Government admits to the first sentence and admits the Administrative Law Judge's decision dated April 13, 1990 became final after 15 days following plaintiffs' failure to seek discretionary review by the Secretary. The government denies plaintiffs have exhausted their administrative remedies.

17. Admitted.

18. The Government admits that the allegations in paragraph 18 are supported in the Administrative Law Judge's findings on pages 3 and 4 of his Order and defers to the Administrative Law Judge's decision.

19. The Government admits to the allegations in paragraph 19, but refers the Court to the Administrative Law Judge's findings on pages 25 and 26 of the Order that the transactions were *not* refinance transactions.

20. The Government admits that the allegations in paragraph 20 are supported in the Administrative Law Judge's findings on pages 5 through 8 of the Order and refers the Court to these pages.

21. The Government admits that the allegations in paragraph 21 are supported in the Administrative Law Judge's findings on page 8 of the Order.

22. The Government denies the first sentence in paragraph 22. The Government is without sufficient information to form a belief as to the truth of the second sentence and therefore denies the same. The Government admits that the remaining allegations in paragraph 22 are supported in the Administrative Law Judge's findings on page 11 of the Order, and refers the Court to the additional findings by the Administrative Law Judge with regard to Messrs. Granat and DesChamps at the November 1981 meeting.

23. The Government admits that the allegations in the first and second sentences in paragraph 23 are supported by the Administrative Law Judge's findings on page 11 of the Order. The Government denies the allegations in the remaining sentences because, as the Administrative Law Judge found at pages 11 and 12 of his Order, Ms. Studer gave advice "[b]ased upon the description of the transaction she was given" by Mr. DesChamps.

24. Defendants admit that the applications for HUD insurance, in the names of Mid-South employees as straw-buyers, include the representation that the purpose of the loans was to "refinance," but deny the remaining allegations of this paragraph.

25. Denied.

26. Denied.

27. The Government admits that the allegations in paragraph 27 are supported, in part, by the Administrative Law Judge's findings on page 13 of the Order. Defendants deny that Mr. Garvin "was satisfying the rule of seven," as characterized in the first sentence of paragraph 27, because he was, instead, circumventing this rule as found by the Administrative Law Judge at page 24.

28. The Government denies the allegation that Mr. Darby used Garvin's "financing program on only two occasions," as Darby used the "program" or scheme to obtain FHA mortgage insurance on approximately 92 properties containing 144 units. The Government denies the second sentence.

29. Admitted, except that the Government denies it was one of two occasions.

30. Admitted, except that the Government denies there were only two occasions.

31. Defendants admit the first sentence; Defendants deny as to the second sentence.

32. Admitted, except the Government denies that the approvals were "duly" granted by HUD.

33. Admitted, except the Government denies that Mr. DesChamps explained in detail to Ms. Studer the workings of the Mid-South program."

34. The Government denies the first sentence in that the Columbia office contacted HUD headquarters not to review the acceptability of the "Mid-South financing program" but to review a *proposal* of the "program." The Government admits to the next two sentences. The Government is without sufficient knowledge to either admit or deny the allegations of the fourth sentence that it was the first time a HUD official "indicated" disapproval; but the Government admits this was the first written request

for approval and, therefore, the first written disapproval. As to the fifth sentence, the Government alleges that the Bay Tree and Oakfield properties had been closed approximately seven months prior to the written disapproval, but admits to the rest of this sentence and the last sentence.

35. The Government denies the first sentence, and alleges the mortgage loans "went into default" because mortgagors failed or refused to make their mortgage payments. The Government disagrees with the characterization that the efforts of Messrs. Darby and Garvin were "herculean" or that their motives were limited to avoiding foreclosure and insurance claims. The remainder of the paragraph is admitted.

36. The Government is without sufficient knowledge to either admit or deny this paragraph, and defers to the findings of the Administrative Law Judge.

37. Admit that the allegations of this paragraph are supported by the ALJ's findings at page 22.

38. Admit that the allegations of this paragraph are supported by the ALJ's findings at page 22.

39. Admitted.

40. Admitted, except that as to the fifth sentence the attorneys for the Government are without sufficient information either admit or deny that the HUD Regional Office received the editorial and therefore it is denied. Further, the Defendants deny the implication that publicity caused the Defendants to propose debarment of Plaintiffs.

41. The first sentence is admitted. The Government admits an exact replication of the Mid-South financing scheme would not receive approval today.

42. Admitted.

43. The United States admits the ALJ made the conclusions alleged in this paragraph.

44. Admitted.

45. Admitted.

46. On information and belief Mr. Darby and his affiliated companies are capable of conducting business with non-government entities and accordingly the United States denies the allegations of this paragraph.

47. Denied.

48. The Government's answer to paragraph 1 through 47 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

49. Denied.

50. Denied.

51. Denied.

52. The Government's answers to paragraphs 1 through 51 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

53. Denied.

54. The Government's answers to paragraphs 1 through 53 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

55. Denied.

56. Denied.

57. The Government's answers to paragraphs 1 through 56 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

58. Denied.

59. The Government's answers to paragraphs 1 through 58 of Plaintiffs' Complaint are hereby adopted by reference just as if they are fully set forth herein.

60. Denied.

61. The Government's answers to paragraphs 1 through 60 of Plaintiffs' Complaint are hereby adopted by reference just as if they were fully set forth herein.

62. Admitted.

63. Denied.

64. Further answering Plaintiffs' Complaint all averments not specifically admitted, are hereby denied and strict proof thereof is hereby demanded.

#### Government's Affirmative Defense

1. Plaintiffs have failed to state a cause of action upon which relief can be granted.

2. Plaintiffs have failed to exhaust their administrative remedies.

3. Plaintiffs' Complaint as to the request for relief from the Limited Denial of Participation is moot.

WHEREFORE, Defendants having fully answered the Complaint pray that the Court will dismiss the Complaint and grant costs to the Defendants herein.

Respectfully submitted,

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Supreme Court, U.S.  
**FILED**

No. 91-2045

**DEC 17 1992**

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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1992

R. GORDON DARBY, *et al.*,  
*Petitioners,*

v.

JACK KEMP, *et al.*,  
*Respondents.*

On Writ of Certiorari to the  
United States Court of Appeals  
for the Fourth Circuit

**BRIEF FOR THE PETITIONERS**

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BEST AVAILABLE COPY

### **QUESTION PRESENTED**

Can a federal appeals court impose an exhaustion requirement as a "rule of judicial administration" notwithstanding Section 10(c) of the Administrative Procedure Act and thereby foreclose judicial review of final adverse agency action, based upon a litigant's failure to pursue a permissive administrative appeal that is not required by statute or agency regulation?

## LIST OF PARTIES

The petitioners are R. Gordon Darby; Darby Development Company; Darby Realty Company; Darby Management Company, Incorporated; MD Investment; Parkbrook Acres Associates; and Parkbrook Developers.\* Respondents are Jack Kemp, Secretary of Housing and Urban Development; Arthur J. Hill, Assistant Secretary for Housing/FHA Commissioner; the United States Department of Housing and Urban Development; and the United States of America.

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\* Pursuant to Supreme Court Rule 29.1, petitioners state that there are no parent companies or subsidiaries of petitioners.

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1992

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No. 91-2045

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R. GORDON DARBY, *et al.*,  
v. *Petitioners,*

JACK KEMP, *et al.*,  
*Respondents.*

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**On Writ of Certiorari to the  
United States Court of Appeals  
for the Fourth Circuit**

---

**BRIEF FOR THE PETITIONERS**

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**OPINIONS BELOW**

The opinion of the court of appeals (Pet. App. A at 1a-7a) is reported at 957 F.2d 145. The orders of the district court (Pet. Apps. B, C, pp. 8a-32a) are unreported.

**JURISDICTION**

The judgment of the court of appeals was entered on February 26, 1992. A petition for rehearing with a suggestion for rehearing in banc was denied on March 20, 1992 (Pet. App. F at 93a). The petition for a writ of certiorari was filed on June 18, 1992 and was granted on November 2, 1992. The jurisdiction of the Court rests upon 28 U.S.C. 1254(1).

### STATUTE INVOLVED

Section 10(c) of the Administrative Procedure Act, 5 U.S.C. § 704, entitled "Actions Reviewable," provides in pertinent part:

Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the section meanwhile is inoperative, for an appeal to superior agency authority.

### STATEMENT OF THE CASE

This is a suit seeking declaratory and injunctive relief from administrative sanctions imposed upon petitioners—Mr. Darby and his affiliates (hereafter, collectively, "Mr. Darby")—by the United States Department of Housing and Urban Development ("HUD"). Respondents (hereafter, "HUD" or the "government") moved to dismiss the suit for failure to exhaust administrative remedies. The district court denied this motion and proceeded to grant relief to Mr. Darby, holding that HUD's sanctions were not rationally supported by the facts and had been imposed for forbidden punitive purposes. The court of appeals reversed, ruling that Mr. Darby had failed to exhaust all available administrative remedies.

Petitioner Robert Gordon Darby is a respected South Carolina real estate developer. In 1982 and early 1983, he financed several housing projects pursuant to a complex plan predicated upon securing HUD single family mortgage insurance for those properties.<sup>1</sup> This financing

<sup>1</sup> The details of this financing plan are not relevant to the issues presented in this appeal. Those details were reviewed by the district court in its order granting relief to Mr. Darby. (Pet. App. at 9a-12a). Previously, they were recounted at even greater length by

plan had been devised in 1981 by a reputable mortgage banker, with whom Mr. Darby had done business for many years. After discussing the plan with HUD and being advised that it complied with relevant HUD requirements, the banker utilized it to finance a number of projects in which he was involved. The banker explained the financing plan to Mr. Darby and helped him to use it. (Pet. App. B at 9a-12a; Pet. App. D at 55a-61a).

Subsequently, in September 1983, HUD deemed this financing plan unacceptable on the grounds that it circumvented applicable regulations. Before HUD halted its use, over a thousand properties in South Carolina had been financed pursuant to this plan. Mr. Darby's properties were only a small fraction of this total. (Pet. App. B at 11a-12a)

Several years later, due to economic circumstances beyond the control of the developers, virtually all of the mortgage loans financed pursuant to this plan went into default. Despite "Herculean efforts" on Mr. Darby's part to resolve the problems and save his projects from financial downfall, his loans defaulted too.<sup>2</sup> These defaults caused HUD to pay substantial mortgage insurance claims to the lenders holding the defaulted loans. (Pet. App. B at 12a).

This insurance loss led to an investigation of the financing plan. A HUD audit conducted in 1986 concluded that there had been no wrongdoing on the part of anyone, including Mr. Darby, and that HUD had not been misled in any way. (Pet. App. B at 12a-13a). Nonetheless, in 1989 HUD instituted administrative sanctions against Mr. Darby for having used this financing plan.<sup>3</sup>

the HUD Administrative Law Judge in his initial decision and order. (Pet. App. D at 44a-61a).

<sup>2</sup> The description of Mr. Darby's efforts as "Herculean" was coined by the HUD Administrative Law Judge and repeated by the district court.

<sup>3</sup> HUD's regulations governing the imposition of administrative sanctions appear at 24 C.F.R. pt. 24 (1990). The procedures con-

On June 19, 1989, HUD imposed a Limited Denial of Participation ("LDP") that prohibited Mr. Darby from taking part in certain HUD housing programs in South Carolina for one year. Mr. Darby unsuccessfully contested the issuance of this LDP at an administrative conference, and then initiated an administrative appeal on July 21, 1989. (Pet. App. B at 13a).

In a separate action, by notice dated August 23, 1989, the HUD Assistant Secretary for Housing proposed to debar Mr. Darby and his affiliates from participating in virtually all federal programs for a period of five years, because of his utilization of the financing plan.<sup>4</sup> The length of the proposed debarment subsequently was increased to an indefinite period. (Pet. App. B at 13a; Pet. App. D at 34a & n.1).

Under HUD's regulatory scheme, the initiation of these administrative sanctions caused Mr. Darby to be excluded immediately from participating in federal programs. This exclusion continued throughout the duration of the administrative proceedings in which Mr. Darby contested the sanctions.<sup>5</sup>

The LDP appeal and the debarment action were consolidated for hearing before a HUD administrative law judge ("ALJ"). A four-day evidentiary hearing was conducted in December 1989. (Pet. App. B at 13a).

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trolling hearings and appeals in such matters are set forth in §§ 24.313 and 24.314, and in 24 C.F.R. pt. 26.

<sup>4</sup> A person who is debarred may not participate in "covered transactions" in federal nonprocurement programs or in federal procurement activities. 24 C.F.R. §§ 24.105(f), 24.200 (1990).

<sup>5</sup> A LDP is effective immediately upon its issuance. 24 C.F.R. § 24.710(b) (1990). Furthermore, evidence that a cause for debarment may exist is itself a cause for suspension. 24 C.F.R. § 24.405 (a)(2) (1990). Thus, as is standard practice in such cases, Mr. Darby was suspended for the duration of the debarment proceedings against him once HUD issued the notice of proposed debarment.

On April 13, 1990, ten months after the administrative proceedings had commenced, the ALJ issued a lengthy written decision and order, which included detailed factual findings (Pet. App. D at 33a-90a). The ALJ upheld the LDP and concluded that Mr. Darby should be debarred for a period of 18 months. (Pet. App. B at 13a). The ALJ ruled that the financing plan was a sham which improperly circumvented applicable requirements and that Mr. Darby "cannot hide behind the fact that government employees approved the program when he, in the first instance, knew or should have known that it was improper." (Pet. App. D at 82a).

Neither Mr. Darby nor HUD sought discretionary intra-agency review of the ALJ's ruling pursuant to 24 C.F.R. § 24.314(c) (1990) which provides that:

The hearing officer's determination shall be final unless . . . the Secretary . . . within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer. . . . Any party may request such a review in writing within 15 days of receipt of the hearing officer's determination.

Accordingly, the ALJ's decision and order became HUD's final agency action.

Meanwhile, HUD's sanctions had been in effect throughout the pendency of the administrative proceedings. Ten months of the twelve-month LDP period and of the eighteen-month debarment period had already elapsed. At this point, Mr. Darby sought judicial redress. On May 31, 1990, Mr. Darby filed suit in the United States District Court for the District of South Carolina seeking injunctive and declaratory relief on the grounds that the administrative sanctions violated provisions of the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 701-06, and due process rights guaranteed by the Fifth Amendment. (J.A. at 2-22). Simultaneously, Mr. Darby filed a motion for preliminary injunctive relief.

HUD moved to dismiss the suit for failure to exhaust administrative remedies because Mr. Darby had not petitioned for Secretarial review under 24 C.F.R. § 24.314(c) (1990). The district court denied this motion in an order filed on October 26, 1990. The court noted that neither HUD's regulation nor the APA expressly required exhaustion as a precondition to obtaining judicial review. Therefore, the court reasoned, it was guided by "the general rule at common law that administrative remedies must be exhausted prior to proceeding in court." Nonetheless, the district court concluded that there were several reasons why this rule should not be applied blindly to require exhaustion in this case. The first was that "a dismissal would leave the decision of the ALJ wholly unreviewed" because the time for an agency appeal had passed. Second, the administrative remedy was inadequate because the regulations gave the Secretary too much latitude in determining the time limits within which to issue a decision. Finally, the court found that resort to Secretarial review would have been futile (Pet. App. C at 27a-29a).

The district court proceeded to consider the suit on its merits. Although the court denied Mr. Darby's motion for a preliminary injunction, it ultimately granted his motion for summary judgment on April 10, 1991. The court vacated the administrative sanctions based upon its conclusion that "the debarment in this case was not rationally connected to the factual findings of the ALJ, and was further in conflict with the prohibition against imposing debarment for punitive reasons." (Pet. App. B at 17a).

On appeal to the Fourth Circuit, HUD challenged only the district court's ruling on exhaustion.<sup>6</sup> HUD contended

<sup>6</sup> Although HUD also noted an appeal of the district court's ultimate ruling that the debarment of Mr. Darby was arbitrary and unlawful, it subsequently abandoned that issue.

that its regulation, 24 C.F.R. § 24.314(c), *required* Mr. Darby to seek Secretarial review as a prerequisite to filing suit in federal court.<sup>7</sup> The circuit court rejected this contention, holding that the regulation "does not expressly mandate exhaustion of administrative remedies prior to filing suit." (Pet. App. A at 6a-7a). Nonetheless, the court held that, as a "rule of judicial administration," exhaustion is still required "even when a statute does not impose an explicit directive." (Pet. App. A at 4a).

Proceeding from this premise, the circuit court ruled as follows:

In the absence of a statutory requirement of exhaustion, the district court properly turned to the judicial doctrine of exhaustion of administrative remedies and to possible avoidance of the rule by application of its exceptions. Our review, however, reveals that the facts do not warrant application of the exceptions. Therefore, the district court improperly denied the Secretary's motion to dismiss. We reverse and remand with instruction to dismiss Darby's complaint for failure to exhaust administrative remedies.

(Pet. App. A at 7a). The circuit court made no reference to Section 10(c) of the APA, although that statutory provision was prominently cited in Mr. Darby's brief and during oral argument.

The Fourth Circuit's ruling left Mr. Darby without any recourse since the fifteen-day period in April 1990 during which he could have requested discretionary Secretarial review had long since passed. However, the circuit court was unperturbed by this result.

Yet Darby, by strategic decision or otherwise, allowed the filing period to pass. He cannot now complain that the decision is unreviewable.

(Pet. App. A at 6a).

<sup>7</sup> It was undisputed that there is no other statutory or regulatory exhaustion provision applicable to this case.

Mr. Darby petitioned for rehearing, with a suggestion for rehearing in banc, on the grounds that the court's decision contravened Section 10(c) and was in conflict with the decisions of other circuits which follow that statutory mandate. The Fourth Circuit denied this petition without opinion on March 20, 1992. (Pet. App. F at 93a).

### SUMMARY OF ARGUMENT

The Fourth Circuit has created a novel and insupportable "rule of judicial administration" that any possible administrative appeal must be exhausted before judicial review may be sought under the APA, even though such exhaustion is not required by relevant statutes or regulations. This ruling amounts to a judicial repeal of Section 10(c) of the APA, in which Congress explicitly provided that a litigant seeking judicial review of a final agency action *need not exhaust* available administrative appeals *unless* such exhaustion is *expressly required by statute or agency rule*. 5 U.S.C. § 704.

The exhaustion doctrine is subordinate to Congress' constitutional authority to prescribe the jurisdiction of federal courts. *McCarthy v. Madigan*, — U.S. —, —, 112 S.Ct. 1081, 1086 (1992). Congress has codified the exhaustion requirement for suits under the APA in Section 10(c) of that Act. *Bowen v. Massachusetts*, 487 U.S. 879, 903 (1988). The plain language of Section 10(c), which is completely confirmed by its legislative history, provides that exhaustion of intra-agency appeals is not necessary except to the extent that other statutes or appropriate agency rules command otherwise. In this case, there is no such statute or agency rule. The circuit court deprived Mr. Darby of judicial relief from an arbitrary agency sanction based on a purported "rule of judicial administration" that flouts Section 10(c) of the APA.

The Fourth Circuit's decision conflicts with the decisions of other federal courts which have held, correctly,

that Section 10(c) controls the exhaustion issue presented here. It exacerbates the disarray among the circuits about the proper application of the exhaustion doctrine and the impact of Section 10(c).

Moreover, the circuit court's decision conflicts with two decisions of this Court. It is inconsistent with this Court's opinion in *ICC v. Brotherhood of Locomotive Engineers*, 482 U.S. 270, 284-85 (1987), which recognized that Section 10(c) relieves parties from any requirement to petition an agency for rehearing before seeking judicial review. The circuit court's ruling also is directly at odds with this Court's decision in the pre-APA case of *Levers v. Anderson*, 326 U.S. 219 (1945), which held that a litigant need not exhaust an administrative remedy that is permissive in nature.

Finally, the Fourth Circuit's decision is unsound as a matter of policy. "[T]he general rule that parties exhaust prescribed administrative remedies before seeking relief from the federal courts," *McCarthy v. Madigan*, — U.S. at —, 112 S.Ct. at 1086, makes sense only if the "prescribed" remedies—and the obligation to pursue them—are spelled out in advance for all to see. In contrast, the Fourth Circuit's "rule of judicial administration" fosters obscure agency procedures, confusion among litigants and courts attempting to comply with the exhaustion requirement, sandbag litigation tactics, and arbitrary results when the judicial "rule" is applied.

## ARGUMENT

### I. THE FOURTH CIRCUIT'S DECISION PATENTLY VIOLATES SECTION 10(c) OF THE ADMINISTRATIVE PROCEDURE ACT

Only last term, this Court emphasized that the exhaustion doctrine is subordinate to Congress' fundamental authority to prescribe the jurisdiction of federal courts.

[A]ppropriate deference to Congress' power to prescribe the basic procedural scheme under which a claim may be heard in a federal court requires fashioning of exhaustion principles in a manner consistent with congressional intent and any applicable statutory scheme.

*McCarthy v. Madigan*, — U.S. at —, 112 S.Ct. at 1086. The task of defining the jurisdiction of federal courts is entrusted to the Congress by the Constitution, *Palmore v. United States*, 411 U.S. 389, 400-01 (1973), and federal courts "have no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given." *McCarthy v. Madigan*, — U.S. at —, 112 S.Ct. at 1087 (citing *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 404 (1821)). Therefore, courts must not decline the exercise of jurisdiction pursuant to the exhaustion doctrine unless it is consistent with congressional intent. *Coit Indep. Joint Venture v. FSLIC*, 489 U.S. 561, 579-580 (1989).

The preeminent expression of congressional policy regarding judicial review of administrative action is the APA. Congress enacted the APA to provide a general authorization for review of agency action in the district courts. *Bowen v. Massachusetts*, 487 U.S. at 903.

The legislative material elucidating that seminal act manifests a congressional intention that it cover a broad spectrum of administrative actions, and this Court has echoed that theme by noting that the Administrative Procedure Act's "generous review provisions" must be given a "hospitable" interpretation.

*Abbott Laboratories v. Gardner*, 387 U.S. 136, 140-41 (1967) (footnote omitted) (quoting *Shaughnessy v. Pedreiro*, 349 U.S. 48, 51 (1955)).

In enacting the APA, Congress dealt explicitly with the issue and exhaustion of administrative remedies. It provided in Section 10(c) that:

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

5 U.S.C. § 704 (emphasis added).

"[T]he primary thrust of § 704 was to codify the exhaustion requirement." *Bowen v. Massachusetts*, 487 U.S. at 903. The statute clearly provides that exhaustion of intra-agency appeals is not a prerequisite to judicial review under the APA except to the extent that other statutes or appropriate agency rules command otherwise. See 4 Kenneth C. Davis, *Administrative Law Treatise* § 26.12, at 470 (2d ed. 1983); *New England Coalition on Nuclear Pollution v. United States Nuclear Regulatory Comm'n*, 582 F.2d 87, 99 (1st Cir. 1978). This provision must be construed and enforced according to its plain terms. See generally *Connecticut Nat'l Bank v. Germain*, — U.S. —, —, 112 S.Ct. 1146, 1149 (1992); *Hallstrom v. Tillamook County*, 493 U.S. 20, 24-31 (1989); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989).

Moreover, the legislative history of the APA leaves no doubt that Section 10(c) means exactly what it says. While the legislation was pending before Congress, the Department of Justice submitted to both the Senate and House Committees on the Judiciary a detailed analysis of the statute. It summarized Section 10(c) in the following terms:

Section 10(c): This subsection states (subject to the provisions of section 10(a)) the acts which are reviewable under section 10. It is intended to state existing law. *The last sentence makes it clear that the doctrine of exhaustion of administrative remedies with respect to finality of agency action is intended to be applicable only (1) where expressly required by statute (as, for example, is provided in 49 U.S.C. 17(9)), or (2) where the agency's rules require that decisions by subordinate officers must be appealed to superior agency authority before the decision may be regarded as final for purposes of judicial review.*

S. Rep. No. 752, 79th Cong., 1st Sess. (1945), reprinted in Senate Judiciary Comm., 79th Cong., 2d Sess., *Administrative Procedure Act: Legislative History, 79th Congress*, at 185, 230 (Comm. Print 1946) ("APA Leg. Hist.") (emphasis added); see also *Samuel B. Franklin & Co. v. SEC*, 290 F.2d 719, 724 (9th Cir.), cert. denied, 368 U.S. 889 (1961) (discussing this legislative history).

The Senate Judiciary Committee's report on the APA includes the following discussion of Section 10(c):

The last clause, permitting agencies to *require by rule* that an appeal be taken to superior agency authority before judicial review may be sought, is designed to implement the provisions of section 8(a). Pursuant to that subsection an agency may permit an examiner to make the initial decision in a case, which becomes the agency's decision in the absence of an appeal to or review by the agency. If there is such review or appeal, the examiner's initial decision becomes inoperative until the agency determines the

matter. For that reason *this subsection permits an agency also to require by rule that, if any party is not satisfied with the initial decision of a subordinate hearing officer, the party must first appeal to the agency (the decision meanwhile being inoperative) before resorting to the courts. In no case may appeal to "superior agency authority" be required by rule unless the administrative decision meanwhile is inoperative, because otherwise the effect of such a requirement would be to subject the party to the agency action and to repetitious administrative process without recourse. There is a fundamental inconsistency in requiring a person to continue "exhausting" administrative processes after administrative action has become, and while it remains, effective.*

S. Rep. No. 752, 79th Cong., 1st Sess. (1945), reprinted in APA Leg. Hist. at 185, 213 (emphasis added). The House Judiciary Committee report contains a virtually identical description of Section 10(c). H. Rep. No. 1980, 79th Cong., 2d Sess. (1946), reprinted in APA Leg. Hist. at 233, 277.

Finally, this construction of Section 10(c) is confirmed by the Government's own most authoritative interpretation of the APA, the 1947 *Attorney General's Manual on the Administrative Procedure Act*, which this Court has repeatedly given great weight. See *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 218 (1988) (Scalia, J., concurring). That manual discusses the import of Section 10(c) in the following terms:

The last clause of section 10(c) permits an agency to require *by rule* that in such cases parties who are dissatisfied with the "initial" decisions of hearing officers must appeal to the agency before seeking judicial review, but only if the agency further provides that the hearing officers' decisions shall be inoperative pending such administrative appeals.

*Attorney General's Manual on the Administrative Procedure Act* 104 (1947) (emphasis in the original).

Thus, the logic and the command of Section 10(c) are clear and simple. On one hand, it freely permits an agency (by appropriate rule) or Congress (by statute) to require exhaustion of intra-agency appeals. Conversely, absent the imposition of such a requirement, it provides a litigant aggrieved by a final agency decision with the right to seek immediate relief in federal court under the APA.

There is nothing novel in this codification of the exhaustion doctrine. The essence of that doctrine has always been that "no one is entitled to judicial relief for a supposed or threatened injury until the *prescribed* administrative remedy has been exhausted." *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938) (emphasis added). Section 10(c) simply ordains which administrative remedies will be considered "prescribed" for exhaustion purposes.<sup>8</sup>

Significantly, Section 10(c) mandates that exhaustion requirements shall be spelled out for all to see. It thereby implements the overarching purpose of the APA—to curb arbitrary agency action, to promote the rule of law, and to avoid situations where parties before agencies are subject to procedural pitfalls and unfair surprises. Moreover, the statute's insistence upon clear procedural ground rules was fully consonant with existing law. Shortly before the enactment of the APA, this Court had refused to require exhaustion of an administrative rem-

<sup>8</sup> While Section 10(c) resolves the exhaustion issue in many cases, including this one, it does not completely supplant the judicially developed exhaustion doctrine. For example, Justice White noted, in *McKart v. United States*, 395 U.S. 185, 207 n.2 (1969) (White, J., concurring in result), that the administration of the military draft laws is not covered by the APA, and so the need to exhaust agency remedies in that case was governed by the judicial exhaustion doctrine rather than by Section 10(c).

edy where the applicable regulations did not expressly provide that pursuit of the remedy was a precondition to judicial review. *Levers v. Anderson*, 326 U.S. 219 (1945).

In this case, HUD is seeking to get through litigation what it never got through rulemaking—a mandatory exhaustion requirement. The agency easily could have imposed an exhaustion requirement by regulation, in conformance with Section 10(c). The agency having failed to do so, the government importuned the Fourth Circuit to impose a judicial exhaustion requirement retroactively and in blatant contravention of Section 10(c).

Mr. Darby, for his part, complied with the letter and the spirit of the APA. He diligently pursued his administrative remedies at HUD for almost an entire year—enduring the contested sanctions all the while—before turning to the district court for redress. He sought judicial review only after a full factual record had been created before the agency and after a detailed decision had been rendered by the agency—a decision that was final according to HUD's own regulations. No statute or regulation required any further exhaustion of administrative remedies. Consequently, under Section 10(c) of the APA, Mr. Darby had an absolute right to seek relief in the district court at that juncture.

The "rule of judicial administration" which the circuit court propounded to divest the district court of jurisdiction and deny Mr. Darby relief subverts Section 10(c). It accomplishes exactly what Congress sought to proscribe—it subjects Mr. Darby to the agency sanction and to repetitious administrative process without recourse, thereby enshrining the "fundamental inconsistency" of requiring continued "exhaustion" of agency processes while the administrative action remains effective.<sup>9</sup> Moreover, as ap-

<sup>9</sup> HUD may deny that there is any such fundamental inconsistency here, because its "regulations provide that the ALJ's decision is inoperative pending review by the Secretary." See Br. in Opp. 9 n.5. However, such an argument elevates form over sub-

plied in this case, the circuit court's "rule" operated to deprive Mr. Darby of any right to judicial review whatsoever. Not only is such a rule unfair and unsound but, more importantly, it is a judicial usurpation of legislative authority.

## II. THE FOURTH CIRCUIT'S DECISION IS IN CONFLICT WITH OTHER CIRCUIT COURT DECISIONS AND APPLICABLE DECISIONS OF THIS COURT

Section 10(c) frequently has been overlooked by federal courts, thereby creating needless and detrimental complexity in the application of the exhaustion doctrine. See 4 Kenneth C. Davis, *Administrative Law Treatise* § 26.12, at 468 (2d ed. 1983). This Court recently repeated Professor Davis' complaint that Section 10(c) "has been almost completely ignored in judicial opinions." *Bowen v. Massachusetts*, 487 U.S. at 902 (1988).

Nonetheless, the majority of federal courts which have addressed the issue have recognized that Section 10(c) governs exhaustion of administrative remedies for purposes of judicial review under the APA, and that it dispenses with any requirement to exhaust intra-agency appeals unless another statute or an appropriate agency rule commands otherwise. *Gulf Oil Corp. v. United States Dep't of Energy*, 663 F.2d 296, 308 n.73 (D.C. Cir. 1981); *New England Coalition on Nuclear Pollution v. United States Nuclear Regulatory Comm'n*, 582 F.2d at 99 (1st Cir. 1978); *Mount Sinai Hosp. of Greater Miami v. Weinberger*, 376 F. Supp. 1099, 1124-25 (S.D. Fla. 1974), *rev'd on other grounds*, 517 F.2d 329 (5th Cir. 1975), *cert. denied*, 425 U.S. 935 (1976); see also *Steere Tank Lines, Inc. v. ICC*, 675 F.2d 763, 766 (5th Cir.

stance. As explained above, the HUD regulatory scheme subjects a person to administrative sanctions while he contests them before the agency. Therefore, any obligation to pursue an intra-agency appeal as a prerequisite to judicial review effectively subjects the respondent to repetitious administrative process without recourse.

1982). The Fourth Circuit's ruling conflicts with these decisions.

One circuit court has stated that a federal court may impose an exhaustion requirement notwithstanding Section 10(c). *Montgomery v. Rumsfeld*, 572 F.2d 250, 253 n.3 (9th Cir. 1978).<sup>10</sup> Another circuit recently held that judicial discretion controls the resolution of an exhaustion issue and implied that the dictates of Section 10(c) might be outweighed by other considerations in resolving a particular case. *Missouri v. Bowen*, 813 F.2d 864, 870-71 & n.15 (8th Cir. 1987). However, no other federal court has adopted the extreme position taken by the court below—that exhaustion of all available administrative remedies is *always* required as a "rule of judicial administration" unless some exception to the exhaustion doctrine applies.

Furthermore, the Fourth Circuit's decision is inconsistent with applicable decisions of this Court. In *ICC v. Brotherhood of Locomotive Engineers*, 482 U.S. 284-85 (1987), the Court noted that:

[Section 10(c)] has long been construed by this and other courts . . . to relieve parties from the *requirement* of petitioning for rehearing before seeking judicial review (unless, of course, specifically re-

<sup>10</sup> In expressing this view, the Ninth Circuit retreated from its previous decision in *United States v. Consolidated Mines & Smelting Co.*, 455 F.2d 432, 440, 451-52 (9th Cir. 1971). Ironically, the *Consolidated Mines* decision had garnered widespread scholarly praise for its application of Section 10(c) to resolve the exhaustion issue. See Project, *Federal Administrative Law Developments—1971, 1972* Duke L.J. 115, 298-99 (1972) (*Consolidated Mines* "has finally brought judicial application of the doctrine of exhaustion of administrative remedies into conformity with the mandate of section 10(c)."); 4 Kenneth C. Davis, *Administrative Law Treatise* § 26.12, at 470 (2d ed. 1983) (describing *Consolidated Mines* as the "outstanding" example of a court discovering and following Section 10(c)). Other circuits have ignored the Ninth Circuit's later decision in *Montgomery v. Rumsfeld* and, instead, have cited its earlier decision in *Consolidated Mines*. See *Gulf Oil Corp. v. United States Dep't of Energy*, 663 F.2d at 308 n.73 (D.C. Cir. 1981).

quired to do so by statute—see, *e.g.*, 15 U.S.C. § 717r, 3416(a)) . . .

(emphasis in the original). Section 10(c) equates a petition “for any form of reconsideration” with “an appeal to superior agency authority” insofar as the need for exhaustion is concerned. The only distinction is that Section 10(c) permits an agency to require by rule an appeal to superior agency authority, whereas a petition for reconsideration of rehearing can only be a prerequisite to judicial review if expressly required by statute. Therefore, in the absence of a statutory or regulatory exhaustion requirement, Section 10(c) relieves parties from the obligation to pursue intra-agency appeals just as surely as it relieves them from the need to file petitions for rehearing.

The circuit court’s decision also is directly at odds with this Court’s decision in the pre-APA case of *Levers v. Anderson*, 326 U.S. 219 (1945). In that case, as here, the government contended that the litigant should have exhausted an administrative remedy which was permissive in nature before seeking judicial relief. The Court rejected this contention, declaring itself unpersuaded that “‘may’ means must.” 326 U.S. at 223. Accordingly, the Court reversed the decision of the circuit court, which had denied judicial review based on the litigant’s failure to exhaust that permissive agency remedy.

### III. THE FOURTH CIRCUIT’S RULE OF JUDICIAL ADMINISTRATION CREATES PERNICIOUS EFFECTS THAT CALL FOR EXERCISE OF THIS COURT’S POWER OF SUPERVISION

Not only does the circuit court’s ruling conflict with Section 10(c), with prior decisions of this Court, and with the decisions of other circuits, it establishes a policy which is the antithesis of the clear, simple and fair exhaustion provision adopted by Congress. Indeed, the Fourth Circuit has manufactured a “rule of judicial administration” that has virulent consequences for all sides.

From the perspective of a person aggrieved by final adverse agency action, this “rule” transforms administrative appeals into a gauntlet that must be run before judicial redress can be sought. Every possible administrative appeal must be pursued upon pain of losing the right to judicial review and perhaps forfeiting any recourse whatsoever. The attendant costs and delays will deter many persons from seeking judicial review and will devalue any relief ultimately awarded those litigants who do manage to stay the course.

From the perspective of government counsel, the novel Fourth Circuit rule is a potent and tempting tactical weapon to wield in APA litigation, which will multiply procedural litigation and divert resources from focus on the merits of agency action. Indeed, it is a virtually ideal sandbag with which to dispose of litigants altogether by raising the exhaustion issue in federal court after the time limit for any administrative appeal has expired.

From the agency’s perspective, the circuit court’s rule discourages the promulgation of clear rules governing administrative appeals and the need for exhaustion; to the contrary, it creates an incentive for murky procedures that confuse parties and that can be selectively invoked to the agency’s tactical advantage. At the same time, it needlessly burdens those agencies that do strive to promulgate clear procedures and that do want to maintain a true discretionary review process. Since the circuit court’s rule effectively transforms optional administrative remedies into mandatory ones, those agencies will find their optional appeal procedures being routinely invoked rather than being reserved for use in exceptional cases.

From the perspective of the district courts, this new “rule” will further complicate the resolution of exhaustion issues. Apart from the conflict with Section 10(c), it transforms the exhaustion issue from a doctrine of sound judicial discretion into a formless, unpredictable “rule of judicial administration” with which district courts must comply upon pain of reversal. This rule

usually will be far more difficult to apply than the standards established by Section 10(c). In many cases it may be unclear or debatable whether there exists an available administrative appeal that was not exhausted. And, should the court conclude that an available appeal was not pursued, then it must wrestle with the complexities of whether an exception to the exhaustion doctrine applies.

Judicial review of administrative action has become increasingly important over the years, and constitutes one of the core functions of federal courts in our modern society. The exhaustion principle has a role to play in regulating the exercise of this power of judicial review. Unfortunately, the Fourth Circuit's decision cuts the exhaustion principle loose from its conceptual moorings and transforms it into a hypertechnical "rule of judicial administration" that resembles the discredited common law rules of pleading.

As a matter of sound policy, "the general rule that parties exhaust prescribed administrative remedies before seeking relief from the federal courts," *McCarthy v. Madigan*, — U.S. at —, 112 S.Ct. at 1086, makes sense only if the "prescribed" remedies are, in fact, clearly and unmistakably spelled out in advance for all to see. The Fourth Circuit's decision omits this essential element and thereby creates a rule of exhaustion which fosters obscurity, confusion, and arbitrariness.

More fundamentally, the exhaustion principle is subordinate to Congress' constitutional authority to prescribe the jurisdiction of federal courts. Therefore, just as federal courts *must* require exhaustion where Congress so mandates, they *may not* require exhaustion where Congress has expressed a contrary intent. The Fourth Circuit's decision is directly at odds with the express will of Congress as articulated in Section 10(c) of the APA. It derogates from the obligation of federal courts to exercise the jurisdiction given them and, in the case of the

APA, to protect citizens from unlawful and abusive agency actions.

## CONCLUSION

The judgment of the court of appeals should be reversed and the judgment of the district court, granting relief to Mr. Darby, should be affirmed.

Respectfully submitted,

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**In the Supreme Court of the United States**

OCTOBER TERM, 1992

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R. GORDON DARBY, ET AL., PETITIONERS

*v.*

HENRY G. CISNEROS, SECRETARY OF HOUSING AND  
URBAN DEVELOPMENT, ET AL.

---

ON WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT

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**BRIEF FOR THE RESPONDENTS**

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### **QUESTION PRESENTED**

Whether petitioners were required to exhaust their administrative remedies before seeking judicial review of sanctions recommended by a hearing officer of the Department of Housing and Urban Development.

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BRIEF FOR THE RESPONDENTS

## OPINIONS BELOW

The decision of the court of appeals (Pet. App. 1a-7a) is reported at 957 F.2d 145. The decisions of the district court (Pet. App. 8a-32a) are unreported.

## JURISDICTION

The judgment of the court of appeals was entered on February 26, 1992. A petition for rehearing was denied on March 20, 1992. The petition for a writ of certiorari was filed on June 18, 1992, and was granted on November 2, 1992. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

## STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 10(a) and 10(c) of the Administrative Procedure Act, 5 U.S.C. 702 and 704, and pertinent

(1)

portions of the debarment regulations of the Department of Housing and Urban Development, 24 C.F.R. 24.314 and 24 C.F.R. 26.25(a), are reproduced in an appendix to this brief.

### STATEMENT

Petitioner R. Gordon Darby is a real estate developer who participated in a scheme that used HUD's single-family mortgage insurance program to build, develop, and finance multifamily housing projects. Petitioner sought to evade limitations on the number of HUD-insured properties that could be held by the same borrower in the same location by arranging for straw buyers to temporarily hold title to the properties. Petitioner also sought to evade a minimum investment requirement by characterizing certain transactions as refinances rather than sales. This case involves action taken by HUD against petitioner because of his use of this scheme.

1. Pursuant to Section 203(b) of the National Housing Act, 12 U.S.C. 1709(b), HUD provides for the insurance of single-family mortgages. Pet. App. 38a. The purpose of the Section 203(b) program is to facilitate home ownership by owner-occupants. *Ibid.* Until recently, investors were permitted to obtain insurance under the program in some instances. *Ibid.*<sup>1</sup>

In the early 1980s, use of the Section 203(b) program by investors was subject to two pertinent restrictions. First, Section 203(b) provided that HUD generally could insure no more than 97% of the first \$25,000 of a mortgage and 95% of any ex-

<sup>1</sup> Investors are no longer eligible for mortgage insurance under the single family mortgage insurance program. See Department of Housing and Urban Development Reform Act of 1989, Pub. L. No. 101-235, § 143, 103 Stat. 2036.

cess over \$25,000 for owner-occupants. 12 U.S.C. 1709(b)(2) (1982); see Pet. App. 38a-39a. Investors, however, were subject to more stringent limits; HUD would not insure more than 85% of a mortgage obtained by an investor. 12 U.S.C. 1709(b)(8) (1982); see Pet. App. 38a n.4. In cases in which the insured mortgage was sought in a refinancing transaction, no minimum investment was required of either an owner-occupant or an investor. Pet. App. 39a & n.5.

Second, pursuant to a HUD regulation known as the "Rule of Seven," 24 C.F.R. 203.42 (1982), HUD limited the number of HUD-insured properties that a single borrower could own in a single location. The regulation provided that a mortgage on a property containing a dwelling unit to be rented by the mortgagor was ineligible for insurance if the property was part of (or adjacent or contiguous to) a group of eight or more related properties in which the mortgagor or principal had any financial interest. Pet. App. 40a. The Rule of Seven was intended to reduce the risk of mass defaults by limiting the number of single-family mortgages given to a single borrower in a particular location. Pet. App. 41a. Other HUD programs, with different and more stringent underwriting requirements, were designed to control the increased risks of large-scale defaults when HUD insures a large number of mortgages for a single developer in a single area. Pet. App. 41a-42a.

2. In 1982, petitioners Darby, Darby Development Company (a company of which Darby was sole owner), and MD Investment (a partnership between Darby and a builder named Curtis Martin) owned 44 completed but unsold townhouses in two housing developments in South Carolina known as Bay Tree and Oakfield. Pet. App. 55a-56a. Those properties

were subject to outstanding loans at high interest rates, and Darby needed to obtain permanent financing at a lower rate. Pet. App. 56a. Darby also had an ownership interest in 52 properties at a development known as Parkbrook Acres. Pet. App. 60a. The other owner of Parkbrook Acres, Lonnie Garvin, Jr., was the President of Mid-South Mortgage Company. Garvin originated and participated in the scheme to circumvent HUD's statute and regulations. Pet. App. 44a, 60a.<sup>2</sup>

With respect to the Bay Tree and Oakfield properties, Darby arranged for applications for HUD-insured mortgages to be submitted between August and November 1982. Pet. App. 59a. Darby completed seven applications in his own name. Pet. App. 57a & n.28. Darby arranged for title to each of the remaining properties to be transferred to Garvin or to one of three employees of Mid-South. Transfer was effected by a deed which indicated that the property had been sold to the transferee for \$5, plus an assumption of the mortgage. Pet. App. 59a. The applications for mortgages for those properties were in the names of the transferees. Pet. App. 59a-60a. Each transferee's mortgage application stated in two places that the loan was a "refinance," and each application stated that the property involved was not a part of or adjacent to any project involving eight or more properties in which the borrower had a financial interest. Pet. App. 58a. Each of the loan closings took place in January 1983. Pet. App. 59a.

<sup>2</sup> Garvin is not a party to this proceeding. He has, however, been debarred twice for violating HUD requirements. See *In re Lonnie A. Garvin, Jr.*, Nos. HUDALJ 90-1415-DB/90-1506DB & 91-1724DB. His challenge to the first debarment is currently pending in district court. *Garvin v. Kemp*, C.A. No. 2:91-1406-18 (D. S.C.).

Approximately three weeks after each closing, the new owner deeded the property back to the original owner—either Darby or a firm in which Darby had an ownership interest. Pet. App. 60a. A similar scheme was used with regard to the Parkbrook Acres properties. *Ibid.*

By using the individual loan applicants as "straw" purchasers and ensuring that no individual held title to more than seven properties at the time of closing, Darby sought to evade the Rule of Seven. Pet. App. 22a. By stating that the purpose of the loan was to "refinance," Darby further avoided the need to make any cash investment in each property. Pet. App. 59a. From the proceeds of the mortgages, Darby and his co-developers paid off the construction loans on the properties and in addition obtained \$529,000 in cash from the Bay Tree and Oakfield projects and \$440,000 from the Parkbrook project. Pet. App. 59a, 61a.

Petitioners later defaulted on all of the HUD-insured mortgages. Pet. App. 61a-66a. HUD was required to pay approximately \$6.6 million in insurance claims on the defaulted loans for the two projects. Pet. App. 65a-66a.

3. On June 19, 1989, HUD issued a limited denial of participation (LDP) that prohibited petitioners from participating in any program in South Carolina administered by the Assistant Secretary for Housing for one year. Pet. App. 13a, 34a. See 24 C.F.R. 24.700 *et seq.* On August 23, 1989, the Assistant Secretary sent petitioners a notice of proposed debarment for a five-year period based on the Bay Tree and Oakfield transactions. See 24 C.F.R. 24.312. On November 16, 1989, after learning of the additional Parkbrook Acres transactions, the Assistant Secretary amended the notice to propose an indefinite debarment. Pet. App. 34a & n.1. For the period of

debarment, an individual or entity that is debarred may not participate in nonprocurement transactions with HUD or any other federal agency and in procurement contracts with HUD. 24 C.F.R. 24.200; see Pet. App. 34a.

Petitioners requested a hearing concerning the LDP and the proposed debarment, and an administrative law judge held a four-day hearing in December 1989. Pet. App. 13a; see 24 C.F.R. 24.313(a). On April 13, 1990, the ALJ issued an "Initial Decision and Order." Pet. App. 33a-90a. Rejecting each of petitioners' defenses on the merits, the ALJ found that the financing method used by petitioners "was a sham which improperly circumvented the Rule of Seven." Pet. App. 69a. The ALJ determined that submission of the mortgage applications in the names of the nominees "was fundamentally improper because their involvement was for the sole purpose of obtaining federally insured mortgages, the benefits of which ran to individuals and entities which could not have obtained that mortgage insurance" under the Rule of Seven. Pet. App. 71a n.35. The ALJ also ruled that petitioners were "required \* \* \* to satisfy the minimum investment requirements," Pet. App. 78a, but avoided those requirements by falsely characterizing the transactions as refinances rather than sales. Pet. App. 71a-72a.

Despite the evidence that petitioners "willfully and materially violated statutory and regulatory provisions and program requirements" and made "false statements on applications for FHA insurance," Pet. App. 79a, the ALJ found that "mitigating factors exist which weigh against imposition of an indefinite debarment." Pet. App. 87a. The ALJ noted that "most of the relevant facts were \* \* \* disclosed to

the [local] HUD \* \* \* Office and a Headquarters employee," that there was a "lack of criminal intent," and that petitioner Darby "genuinely cooperated with HUD to try [to] work out his financial dilemma and avoid foreclosure." Pet. App. 87a-88a. The ALJ found that, under the circumstances, an indefinite debarment would "serve no legitimate purpose." Pet. App. 88a. He therefore concluded that "good cause exist[ed] to debar" petitioners for a period of 18 months. Pet. App. 90a.

Under HUD rules, "[t]he hearing officer's determination shall be final unless \* \* \* the Secretary or the Secretary's designee, within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer." 24 C.F.R. 24.314(c). The rules provide that "[a]ny party may request such a review \* \* \* within 15 days of receipt of the hearing officer's determination." *Ibid.* Petitioners did not seek further administrative review of the ALJ's "Initial Decision and Order." Pet. App. 3a. On June 21, 1990, the Assistant Secretary for Housing-Federal Housing Commissioner issued a "Final Determination" imposing the debarment. Pet. App. 91a-92a.

4. a. On May 31, 1990, prior to the issuance of the Final Determination, petitioners brought suit in district court seeking a declaration that the LDP and debarment violated the Administrative Procedure Act and due process rights guaranteed by the Fifth Amendment. Pet. App. 3a. The district court denied the government's motion to dismiss the case for failure to exhaust administrative remedies. Pet. App. 20a-32a. The court acknowledged that it was guided by "the general rule at common law that administrative remedies must be exhausted prior to proceeding

in court." Pet. App. 28a. But the court declined to apply the doctrine in this case.

The court relied on the fact that the time for filing for review by the Secretary had by that time long passed, and that petitioners accordingly would be denied any judicial review if the exhaustion doctrine were applied. Pet. App. 28a. The court also found that the administrative remedy was inadequate because the Secretary could delay the final disposition of the review proceeding indefinitely by extending the 30-day time periods within which he was required first to decide whether to review the ALJ's decision and then to reach his own decision on the matter. Pet. App. 28a-29a. See 24 C.F.R. 24.314(c), 24.314(e). Finally, the court stated that the administrative remedy would have been "futile," Pet. App. 29a, although the court did not further explain that ruling. The district court later reversed the debarment on its merits. Pet. App. 8a-19a.<sup>3</sup>

b. The court of appeals reversed, holding that petitioners were required to exhaust the available ad-

<sup>3</sup> Although petitioners' LDP and debarment had already expired when the district court reached its final judgment, the district court correctly held that this case is not moot. Pet. App. 14a n.8. Under HUD regulations, participants in HUD programs must inform HUD of any debarments (but not LDPs) within the preceding ten years, 24 C.F.R. 200.219(a) (2) (vi), and HUD may use that information in determining whether the participant is a "responsible \* \* \* organization[]" that "will honor [its] legal, financial and contractual obligations." 24 C.F.R. 200.20; see 24 C.F.R. 200.228. Such collateral consequences of a debarment can preserve the controversy between the parties, notwithstanding the fact that the period of the debarment has expired. See *Caiola v. Carroll*, 851 F.2d 395, 401 (D.C. Cir. 1988); cf. *Sibron v. New York*, 392 U.S. 40, 50-58 (1968); *Carafas v. LaVallee*, 391 U.S. 234 (1968).

ministrative remedy—in this case, review by the Secretary of the ALJ's decision—before seeking judicial review. Pet. App. 4a. The court held that the requirement of exhaustion permits an agency to exercise its discretion and apply its expertise, ensures agency autonomy, and avoids premature intervention by the courts. *Ibid.* The court held that petitioners' failure to exhaust administrative remedies was not excluded by the alleged futility or inadequacy of those remedies. Pet. App. 5a. Nor did the fact that the time for seeking administrative review had already passed excuse their failure to exhaust. The court noted that petitioners, "by strategic decision or otherwise, allowed the filing period to pass," and accordingly "cannot now complain that the decision is unreviewable." Pet. App. 6a. Accordingly, the court of appeals reversed and remanded the case with instructions to dismiss. Pet. App. 7a.

#### SUMMARY OF ARGUMENT

For nearly a century, this Court has recognized the authority of federal courts to require exhaustion of administrative remedies. Petitioners nevertheless contend that when Congress adopted the Administrative Procedure Act in 1946, it provided that courts could not exercise their traditional discretion to require exhaustion, in the interests of administrative and judicial efficiency, for any action brought under the APA. The APA says no such thing, and the court of appeals correctly determined that settled legal principles required exhaustion of the administrative remedy available to petitioners in this case.

I. Petitioners' claim that the judicial doctrine of exhaustion of administrative remedies does not apply to actions for judicial review under the APA rests solely on a circumscribed reading of Section 10(c) of

the APA. That interpretation is in no sense required by the plain language of Section 10(c), is refuted by the language of Section 10(a), and is inconsistent with the legislative history of the APA and this Court's precedents.

A. Section 10(c) provides that courts have jurisdiction to review only "final agency action." Congress further provided in Section 10(c) that this prerequisite for judicial review—the requirement of finality—could be satisfied without completion of an agency appeal "unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative." For this reason, Section 10(c) does not *preclude* review of petitioners' claim. But nor does it *require* review under circumstances where courts would traditionally impose an exhaustion requirement in the interests of administrative and judicial efficiency.

Section 10(c) sets forth the requirement of finality, but it does not address the requirement of exhaustion of administrative remedies. It contains no reference to the term "exhaustion," and provides only that agency action must be final to be "subject to judicial review." The section therefore does not address the question whether courts may continue to impose other conditions on the timing of their exercise of jurisdiction to review final action. Moreover, Section 10(a) of the APA, adopted in 1976, confirmed that "nothing herein \* \* \* affects other limitations on judicial review," and courts adjudicating APA claims retain "the power or duty \* \* \* to dismiss any action or deny relief on any other appropriate legal or equitable ground." 5 U.S.C. 702. The committee reports explaining the addition to Section 10(a) expressly state that this proviso was intended to con-

firm that courts retain authority to require exhaustion of administrative remedies.

B. This Court has never construed Section 10(c) to preclude judicial imposition of appropriate exhaustion requirements. Instead, the Court has previously characterized exhaustion and finality as distinct (but related) doctrines. *McCarthy v. Madigan*, 112 S. Ct. 1081, 1086 (1992). Moreover, in *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158, 162-163 (1967), this Court suggested that issues of finality in APA actions must be resolved under the terms of Section 10(c), but that issues of exhaustion are appropriately considered under pre-APA exhaustion jurisprudence. This interpretation of Section 10(c) also derives support from analogous cases in the areas of ripeness, abstention, and primary jurisdiction. In those areas, the Court has held that a congressional grant of jurisdiction does not preclude courts from deferring adjudication of controversies that should first be presented to another forum. If the same rule were not applied here, litigants would be able to freely bypass available administrative remedies, and federal courts would be required to adjudicate a variety of controversies that could have been resolved more efficiently through agency processes.

II. The court of appeals correctly determined that settled principles required petitioners to exhaust HUD's administrative appeal process. The "general rule" that exhaustion should be required to serve the "twin purposes of protecting administrative agency authority and promoting judicial efficiency" is fully applicable here, because the available administrative remedy would not in any way unduly burden a litigant's right to obtain judicial review of HUD debarment decisions. *McCarthy*, 112 S. Ct. at 1086.

A. Although a hearing officer is authorized to conduct debarment hearings and issue an "initial decision," any party to the debarment may request discretionary review by the Secretary. 24 C.F.R. 24.314(c). During the pendency of the petition for review, the debarment order is not given operative effect, see 48 Fed. Reg. 43,304 (1983), and the Secretary has authority to reach an independent decision as to whether debarment is warranted. 24 C.F.R. 24.314(e). Secretarial review of debarment orders would almost certainly prove to be important in any subsequent district court action because "[e]xhaustion concerns apply with particular force when the action under review involves exercise of the agency's discretionary power or when the agency proceedings in question allow the agency to apply its special expertise." *McCarthy*, 112 S. Ct. at 1086.

B. The administrative remedy at issue here is fair and effective. It does not engender extended delays or present procedural traps. Under time periods established by HUD's regulations for consideration of petitions for review by the Secretary, debarment appeals will ordinarily be resolved in less than three months. Because the debarment order does not take effect during this period, and because the Secretary could grant complete relief by vacating the order, there is no need to grant judicial review prior to exhaustion of this available remedy. Petitioners offered no excuse for their failure to pursue their right to seek review by the Secretary. The court of appeals therefore correctly dismissed petitioner's action.

## ARGUMENT

### I. SECTION 10(c) OF THE ADMINISTRATIVE PROCEDURE ACT DOES NOT EXCUSE PETITIONERS' FAILURE TO EXHAUST ADMINISTRATIVE REMEDIES

It is a "long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938). As this Court explained long ago in *United States v. Sing Tuck*, 194 U.S. 161 (1904), "it is one of the necessities of the administration of justice that even fundamental questions should be determined in an orderly way," *id.* at 168, and an available administrative appeal route therefore "must be followed before there can be a resort to the courts." *Id.* at 167-168. Petitioners' assertion that Section 10(c) of the Administrative Procedure Act (APA), 5 U.S.C. 704, rendered the exhaustion doctrine inapplicable in any action for judicial review under the APA is mistaken. It is not required by the language of Section 10(c), it is squarely contradicted by the 1976 amendment to Section 10(a) of the APA, 5 U.S.C. 702, and it is inconsistent with decisions of this Court. If adopted, the rule proposed by petitioner would disrupt the orderly review of agency action under the APA.

#### A. The Statutory Language And Legislative History Of The Judicial Review Provisions Of The APA Make Clear That The Settled Rule Requiring Exhaustion Of Adequate Administrative Remedies Applies To Cases Brought Under The APA

1. Section 10 of the Administrative Procedure Act, ch. 324, 60 Stat. 243-244 (5 U.S.C. 701-706), creates

and specifies the incidents of a cause of action for judicial review of agency action. See *Lujan v. National Wildlife Fed'n*, 110 S. Ct. 3177, 3186 (1990); *Califano v. Sanders*, 430 U.S. 99 (1977). Section 10(a), 5 U.S.C. 702, provides that "[a] person suffering legal wrong because of agency action \* \* \* is entitled to judicial review thereof." Section 10(b), 5 U.S.C. 703, provides for the form and venue of the proceeding. Section 10(c), 5 U.S.C. 704, the provision at issue in this case, limits that entitlement. It provides, in relevant part:

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsiderations, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

The plain terms of Section 10(c) preclude judicial review of any agency decision that is not final, and specify how the requirement of finality may be satisfied. As the first sentence makes clear, it is only "final agency action" that is "subject to judicial review" under Section 10(c). The second sentence provides that non-final, intermediate actions, though not directly reviewable, are "subject to review on the review of the final agency action." The first part of

the third sentence specifies that an agency decision is final even if agency rehearing proceedings were not requested. The last part of the third sentence specifies that the agency decision will also be regarded as final even if an "appeal to superior agency authority" was not requested, unless an agency rule requires such an appeal and suspends the effect of the decision while the appeal is prosecuted.

By its terms, Section 10(c) thus creates a general "finality" requirement that qualifies the right of access to the courts granted in Section 10(a). Unless agency action meets the finality requirements of Section 10(c), the cause of action created by Section 10(a) is unavailable and judicial review under the APA is precluded. Whatever the prudential considerations that might be thought to justify review of a particular agency action that is not final under Section 10(c), a plaintiff may obtain such review only pursuant to a right of action created by a source of law other than the APA, or not at all.

2. Petitioners' theory is that Section 10(c), by providing that "final agency action \* \* \* [is] subject to judicial review," requires a court to provide such review on demand by the plaintiff, notwithstanding any other source of law—such as the exhaustion doctrine—that controls the timing of such review. Although petitioners assert that their theory rests on the "explicit" terms of Section 10(c), Pet. Br. 8; see *id.* at 11, their theory is not required by the express language or enactment history of the APA. As explained above, the language of Section 10(c) is addressed to a much narrower issue: finality. Section 10(c) *precludes* review unless the agency action is final, but it does not *require* review under circum-

stances where courts would traditionally impose an exhaustion requirement. Nowhere does the statute even mention the exhaustion doctrine, which was already well established at the time the APA was enacted, or the consequences of the prospective plaintiff's failure to exhaust administrative remedies.<sup>4</sup> Section 10(c) includes no direction that courts must disregard their interests in promoting effective and efficient judicial review in all APA actions. See pp. 23-26, *infra*.

Moreover, petitioners' claim that the exhaustion doctrine no longer applies in APA actions is directly contradicted by provisions of Section 10(a) that Congress adopted in 1976. Act of Oct. 21, 1976, Pub. L. No. 94-574, § 1, 90 Stat. 2721. At that time, Congress amended Section 10(a)—the basic provision granting a right of judicial review to those aggrieved by agency action—to eliminate the defense of sovereign immunity in most APA cases. But Congress sought to ensure that other traditional doctrines invoked by courts to limit judicial review remained applicable. Congress therefore provided that “[n]oth-

<sup>4</sup> Numerous statutes expressly require exhaustion of administrative remedies, in some instances subject to qualifications, as a prerequisite to suit in federal court. See, e.g., 7 U.S.C. 1105(a); 25 U.S.C. 1724(i)(3); 26 U.S.C. 7428(b)(2); 26 U.S.C. 7476(b)(3); 26 U.S.C. 7478(b)(2); 28 U.S.C. 2637(b) and (d); 42 U.S.C. 10807(a); 43 U.S.C. 1632(a); 42 U.S.C. 3789d(c)(4)(A); 42 U.S.C. 1632(a). Some statutes, primarily in the civil rights area, expressly excuse a plaintiff's failure to exhaust administrative remedies. See, e.g., 7 U.S.C. 2305(d); 29 U.S.C. 1854(a); 42 U.S.C. 1971(d); 42 U.S.C. 1973j(f); 42 U.S.C. 2000a-6(a). Other statutes require or excuse exhaustion in specific circumstances. See, e.g., 42 U.S.C. 1997e(a); 42 U.S.C. 6104(f).

ing herein \* \* \* affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground.” 5 U.S.C. 702. By recognizing that “other limitations on judicial review” survived the APA and that a court may “dismiss an action or deny relief” on an “appropriate \* \* \* equitable ground,” Congress expressly recognized the continuing applicability of the exhaustion doctrine—as well as other equitable defenses and remedial doctrines—in APA cases.

The enactment history of the 1976 amendment to the APA confirms this interpretation. Both the House and Senate committee reports on the amendment expressly stated that the proviso to Section 10(a) preserved judicial authority to continue to impose exhaustion requirements on APA litigants. The Senate committee report noted that the proviso acknowledged the continuing applicability of “methods found in the substantial and growing body of law governing availability, timing, and scope of judicial review,” and that those “methods” included the “defenses” of “(1) statutory preclusion; (2) lack of ripeness; (3) *failure to exhaust administrative remedies*; and (4) lack of standing.” S. Rep. No. 996, 94th Cong., 2d Sess. 9 (1976) (emphasis added). See also *id.* at 11 (explaining proviso to preserve existing grounds for denial of relief, such as “failure to exhaust administrative remedies”); H.R. Rep. No. 1656, 94th Cong., 2d Sess. 9, 12 (1976). The Department of Justice<sup>5</sup>

<sup>5</sup> In a letter to the Chairman of the Senate Subcommittee on Administrative Practice and Procedure, then-Assistant Attorney General Scalia noted that the “failure to exhaust administrative remedies,” among other doctrines, would continue to be available as a defense in cases previously dismissed

and the Administrative Conference of the United States, which initiated the proposal to amend the APA,<sup>6</sup> manifested a similar understanding that the exhaustion doctrine was an "appropriate \* \* \* equitable ground" on which courts could dispose of cases seeking judicial review.

Congress's express recognition of the continuing vitality of the exhaustion doctrine in 1976—and its enactment of statutory language recognizing that courts may continue to apply such traditional doctrines in APA cases—is fundamentally at odds with petitioners' construction of Section 10(c). The core premise of petitioners' theory is that Section 10(c) repudiated the exhaustion doctrine and required judicial review to proceed notwithstanding traditional equitable defenses governing the timing and availability of such review. Nothing in the language of Section 10(c) requires that conclusion. And Congress's recognition in Section 10(a) of traditional equitable defenses—including the exhaustion doctrine—makes clear that Section 10(c) had not repudiated that doctrine 30 years earlier.

on sovereign immunity grounds. S. Rep. No. 996, 94th Cong., 2d Sess. 26 (1976).

<sup>6</sup> Roger Cramton, who prepared the proposal for the Administrative Conference, explained that abolition of sovereign immunity would not affect "[g]rounds for dismissal or denial of relief under present law," including "[t]he plaintiff's failure to exhaust his administrative remedies." 1 Recommendations and Reports of the Administrative Conference of the United States 222, 223 (1968-1970). Indeed, the Administrative Conference proposal followed the reference to the exhaustion doctrine with a citation to the leading case applying pre-APA exhaustion principles, *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41 (1938), and not to Section 10(c) of the APA.

3. Although petitioners claim (Pet. Br. 12-14) that the legislative history of Section 10(c) supports their construction of the statute, it would make little sense to credit that interpretation of the legislative history in light of the express terms of the proviso adopted in 1976. In any event, the 1945 legislative history, read as a whole, supports the conclusion that Congress did not intend Section 10(c) to eliminate judicial authority to require exhaustion.

Petitioners rely, for example, on an analysis of Section 10(c) by Attorney General Clark reprinted in the Senate Report that accompanied the Act. Pet. Br. 12. The Attorney General initiated his discussion, however, with the statement that Section 10(c) was "intended to state existing law." S. Rep. No. 752, 79th Cong., 1st Sess. 44 (1945). That theme was repeated throughout the legislative history. In introducing the APA on the House floor, Representative Walter, the Chairman of the House subcommittee that drafted it, stated that "the provisions of [Section 10(c)] are technical but involve no departure from the usual and well understood rules of procedure in this field." 92 Cong. Rec. 5654 (1946). See also *Attorney General's Manual on the Administrative Procedure Act* 93 (1947) ("The provisions of section 10 constitute a general restatement of the principles of judicial review embodied in many statutes and judicial decisions. \* \* \* [T]he general principles stated in section 10 must be carefully coordinated with existing statutory provisions and case law."); *id.* at 101 (quoting Rep. Walter's statement).

"[E]xisting law" and "the usual and well understood rules of procedure" at the time the APA was enacted plainly permitted federal courts to require

exhaustion of adequate administrative remedies.<sup>7</sup> Therefore, it is highly unlikely that Section 10(c) was intended to deprive courts of their traditional authority to require exhaustion of administrative remedies (including appeals) when the needs of administrative autonomy and judicial efficiency outweigh private interests in early access to a judicial forum.

Even the portion of Attorney General Clark's statement upon which petitioners rely does not support their argument. The Attorney General stated that "the doctrine of exhaustion of administrative remedies *with respect to finality of agency action* is intended to be applicable only" where required by statute, or in the circumstances set forth in the last sentence of Section 10(c). S. Rep. No. 752, *supra*, at 44 (emphasis added). The clear import of that statement is that exhaustion requirements designed to preclude judicial review of non-final or preliminary agency action would thereafter be applicable only in accord with Section 10(c). As this Court has suggested, however, the doctrine of "finality"—to which Section 10(c) is directed—is distinct from the related doctrine of exhaustion of administrative remedies. *McCarthy v. Madigan*, 112 S. Ct. 1081, 1086 (1992) ("The doctrine of exhaustion of administrative remedies is one among many related doctrines—

<sup>7</sup> See, e.g., *Aircraft & Diesel Corp. v. Hirsch*, 331 U.S. 752 (1947); *Macauley v. Waterman Steamship Corp.*, 327 U.S. 540 (1946); *Illinois Commerce Comm'n v. Thomson*, 318 U.S. 675, 686 (1943); *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 51 n.9 (1938) (citing cases); *First Nat'l Bank v. Board of County Commissioners*, 264 U.S. 450 (1924); *Pacific Live Stock Co. v. Lewis*, 241 U.S. 440 (1916); *United States v. Sing Tuck*, 194 U.S. 161 (1904).

including abstention, finality, and ripeness—that govern the timing of federal court decisionmaking.").

Petitioners also cite excerpts from the legislative history indicating that Congress did not intend to give agencies the power to preclude judicial review altogether by requiring an administrative appeal without suspending the effectiveness of the decision appealed. See Pet. Br. 12-13. But those excerpts do not show that Congress intended to forbid the courts from concluding, as they had been doing for decades, that the need for the orderly administration of justice, agency autonomy, and efficient utilization of judicial resources dictate that plaintiffs generally be required to exhaust prompt, effective administrative appeal processes before seeking judicial review of agency action.

#### B. This Court's Decisions Support The Continued Applicability Of The Exhaustion Requirement In APA Cases

1. This Court has indicated on a number of occasions that the requirement of finality in Section 10(c) is distinct from the exhaustion requirement, which continues to apply to judicial review of APA actions. For example, in *United States v. Standard Oil Co.*, 449 U.S. 232 (1980), the plaintiff claimed that the issuance of a complaint by the FTC was subject to judicial review because the plaintiff had exhausted all of its administrative remedies by moving unsuccessfully for dismissal of the complaint before the agency. The Court held that the plaintiff had "mistaken exhaustion for finality." *Id.* at 243. Although the Court agreed that the plaintiff "may well have exhausted its administrative remedy," *ibid.*, the Court found that the issuance of a complaint was

not a "final" agency action subject to judicial review under Section 10(c). 449 U.S. at 238.

This Court's other cases discussing Section 10(c) also support the view that it addresses issues of finality, but not the distinct question whether the party seeking judicial review should exhaust its administrative remedies for other reasons.<sup>8</sup> For example, in *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158 (1967), the Court noted that the challenged agency regulation was "final" under Section 10(c), 387 U.S. at 162, but ordered the litigants to "exhaust" an available "administrative process" so that "more light may be thrown" on the justifications for the agency action, and thereby put the courts in "a better position" to resolve the issues presented. *Id.* at 166. The Court indicated that the question whether exhaustion would be required was separate from the issue of finality. *Id.* at 163. Further, in its discussion of the exhaustion issue, the Court relied on cases applying the judicially imposed doctrine of exhaustion—not Section 10(c)—as authority. *E.g.*, *Allen v. Grand Central Aircraft Co.*, 347 U.S. 535, 540-541 (1954); *Skinner & Eddy Corp. v. United States*, 249 U.S. 557, 562-563 (1919).

<sup>8</sup> The Court cited Section 10(c) in *Lujan v. National Wildlife Fed'n*, 110 S. Ct. 3177, 3185 (1990), for the proposition that "[w]hen, as here, review is sought \* \* \* only under the general review provisions of the APA, the 'agency action' in question must be 'final agency action.'" See also, *e.g.*, *Franklin v. Massachusetts*, 112 S. Ct. 2767, 2773 (1992); *Bowen v. Massachusetts*, 487 U.S. 879, 902 n.35 (1988) (noting that "it is certainly arguable that by enacting § 704 Congress merely meant to ensure that judicial review would be limited to final agency actions and to those nonfinal agency actions for which there would be no adequate remedy later"); *Abbott Laboratories v. Gardner*, 387 U.S. 136, 149 (1967).

2. Petitioners are mistaken in contending (Pet. Br. 9, 14-15, 17-18) that the decisions of this Court in *ICC v. Brotherhood of Locomotive Engineers*, 482 U.S. 270, 284-285 (1987), and *Levers v. Anderson*, 326 U.S. 219 (1945), support their contention here. In *Brotherhood of Locomotive Engineers, supra*, the Court indicated that a party may generally seek judicial review of agency action without availing itself of an opportunity to file a petition for reconsideration. A petition for reconsideration simply asks the same agency decisionmaker to take a second look at a decision it has already made, and courts traditionally have not required exhaustion of such procedures. See *Levers*, 326 U.S. at 222 & n.3. Further, there was no necessity for the Court in *Brotherhood of Locomotive Engineers* to even examine whether traditional exhaustion principles were superseded by Section 10(c).<sup>9</sup>

*Levers v. Anderson*, 326 U.S. 219 (1945), also did not present the issue raised by petitioners here. The plaintiff in *Levers* failed to file a motion for rehearing—a motion that would not have been required under traditional exhaustion principles. The Court concluded that the motion was "so much like the normal, formal type of motion for rehearing," 326 U.S. at 224, which the government had conceded was

<sup>9</sup> The issue presented was one relating to finality: when did the agency decision become final under circumstances where the litigant had sought reconsideration. In any event, the distinction between motions for reconsideration and appeals to higher authority is a familiar one, and is embodied in other statutes governing judicial review. For example, a district court's decision must ordinarily be reviewed by a court of appeals before this Court will review it, even though the filing of a petition for rehearing with the court of appeals is not a prerequisite to this Court's review.

a "mere formalit[y] which waste[s] the time of litigants and tribunals," *id.* at 222, that it was not a prerequisite to judicial review. Even in that situation, however, the Court noted that it was not deciding whether the reviewing court might have discretionary power to stay its proceedings until the plaintiff sought administrative reconsideration. *Ibid.*<sup>10</sup>

<sup>10</sup> Petitioners state that Section 10(c) "frequently has been overlooked" (Pet. Br. 16), but nonetheless claim that their position is supported by "the majority of federal courts which have addressed the issue" (*Ibid.*). We disagree. Although the Ninth Circuit at one time appeared to have adopted petitioners' position, see *United States v. Consolidated Mines & Smelting Co.*, 455 F.2d 432, 439-440 (9th Cir. 1971), the court even there noted that it is "desirable to give highest agency authority an opportunity to formulate policy and rules before the courts are required to act," *id.* at 439 n.3, and later abandoned petitioners' interpretation in *Montgomery v. Rumsfeld*, 572 F.2d 250, 253 (9th Cir. 1978). Petitioners cite *New England Coalition on Nuclear Pollution v. United States Nuclear Regulatory Comm'n*, 582 F.2d 87, 99 (1st Cir. 1978). But in that case, the agency itself did not regard exhaustion of its internal administrative appeals process as a prerequisite to judicial review. Cf. *Weinberger v. Salft*, 422 U.S. 749, 766-767 (1975) (Secretary may waive further exhaustion). And in *Steere Tank Lines, Inc. v. ICC*, 675 F.2d 763 (5th Cir. 1982), the court reached the same conclusion as did the Fourth Circuit in this case, finding the agency action in question to be final but holding that the plaintiff's failure to take an administrative appeal from that action precluded judicial review. See *id.* at 766. Cf. *Peter Kiewit Sons' Co. v. U.S. Army Corps of Engineers*, 714 F.2d 163, 167-168 (D.C. Cir. 1983) (plaintiff had not satisfied requirement of finality or exhaustion). Finally, the D.C. Circuit's statement in *Gulf Oil Corp. v. United States Department of Energy*, 663 F.2d 296, 308 n.73 (D.C. Cir. 1981), is plainly dictum, and, in any event, that case concerned the unusual situation in which it was alleged that agency officials were engaged in a pattern

3. Outside the context of the exhaustion doctrine, this Court has regularly rejected contentions closely analogous to those of petitioners. A plaintiff's compliance with all statutory requirements for filing suit on a case within a district court's jurisdiction, *i.e.*, a case otherwise "subject to judicial review" in the terms of Section 10(c), 5 U.S.C. 704, has not been sufficient to mandate adjudication of the case. Like exhaustion, a number of other judicial doctrines may still properly affect the time when a plaintiff's claim is appropriate for adjudication.

First, the doctrine of ripeness, some aspects of which are codified in Section 10(c), has been held to bar premature review of agency action, even if the action is final within the meaning of Section 10(c) and otherwise subject to judicial review. See *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158 (1967). Cf. *MacDonald, Sommer & Frates v. County of Yolo*, 477 U.S. 340 (1986); *Brown v. Hotel & Restaurant Employees & Bartenders Int'l Union Local 54*, 468 U.S. 491, 512 (1984). Petitioners' theory that Section 10(c) mandates immediate judicial review of all final agency decisions is inconsistent with those decisions.

The abstention doctrine provides a second example. When applicable, that doctrine requires district courts to refrain from exercising their jurisdiction, even though the plaintiff has complied with all statutory prerequisites for bringing suit. See, *e.g.*, *Railroad Comm'n v. Pullman Co.*, 312 U.S. 496 (1941); *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943); *Younger v. Harris*, 401 U.S. 37 (1971); *Colorado River*

of wrongdoing (including destruction of relevant documents and ex parte communications between the hearing officer and enforcement personnel) that subverted agency processes. *Id.* at 297-298, 309.

*Water Conservation Dist. v. United States*, 424 U.S. 800 (1976). This Court has required dismissal of suits under the abstention doctrine, see e.g., *Alabama Pub. Serv. Comm'n v. Southern Ry.*, 341 U.S. 341 (1951), even where such dismissal could have the effect of eliminating entirely a plaintiff's claim because the state process on which the abstention was based is no longer available. E.g., *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 611 n.22 (1975); *Hicks v. Miranda*, 422 U.S. 332, 351 n.20 (1975).

Similarly, in *National Farmers Union Ins. Cos. v. Crow Tribe of Indians*, 471 U.S. 845 (1985), and *Iowa Mutual Ins. Co. v. LaPlante*, 480 U.S. 9, 19 (1987), this Court held that district courts must decline or postpone the exercise of jurisdiction over claims arising on Indian reservations until the plaintiffs have exhausted any remedies available to them in tribal court, including the pursuit of any tribal appeals. The Court recognized in *National Farmers Union* that the district court had federal question jurisdiction over plaintiffs' claim under 28 U.S.C. 1331, see 471 U.S. at 850-853, and did not cast any doubt on plaintiff's allegation in *Iowa Mutual* that the district court had diversity jurisdiction over its complaint, see 480 U.S. at 16. In terms directly applicable to this case, the Court nonetheless held that "[u]ntil [tribal] appellate review is complete, the [tribal courts] have not had a full opportunity to evaluate the claim and federal courts should not intervene." *Iowa Mutual*, 480 U.S. at 17; accord *National Farmers Union*, 471 U.S. at 857 ("exhaustion is required before [plaintiff's] claim may be entertained by a federal court").<sup>11</sup>

<sup>11</sup> Among the rationales advanced for application of the exhaustion doctrine were the requirements of the "orderly

Finally, under the doctrine of primary jurisdiction, a federal court must decline to hear a claim that is concededly "originally cognizable in the courts," *United States v. Western Pacific R. R.*, 352 U.S. 59, 63-64 (1956), until the plaintiff first seeks relief from an administrative agency. Despite the fact that all jurisdictional and other statutory prerequisites may be met, a district court must suspend its processes or dismiss the case "whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body." *Id.* at 64. See, e.g., *Communications Workers v. Beck*, 487 U.S. 735, 742-743 (1988); *Far East Conference v. United States*, 342 U.S. 570, 577 (1952).

#### C. Petitioners' Construction Of Section 10(c) Would Disrupt Orderly Judicial Review Of Agency Action

Applying petitioners' theory would disturb numerous administrative procedures in which an intermediate agency decision becomes final if no party pursues further internal remedies. The HUD regulations at issue in this case provide an example.

HUD's regulations provide that, at two stages, a party may choose to waive its defenses and permit a debarment to become final. First, a party served with a notice of proposed debarment has 30 days to request a hearing. If no hearing is sought, "the proposed

administration of justice," the need to give a tribal court "a full opportunity \* \* \* to rectify any errors it may have made," and the desirability of giving the federal court "the benefit of [the tribal court's] expertise." *National Farmers Union*, 471 U.S. at 856, 857; see *Iowa Mutual*, 480 U.S. at 16-17. The same principles support application of the exhaustion doctrine in this case.

decision to debar [becomes] final." 24 C.F.R. 24.313(a). Second, if a hearing is sought, the hearing officer's determination that debarment is appropriate "shall be final." 24 C.F.R. 24.314.

Petitioners contend that, because the hearing officer's decision has become final due to their own failure to seek secretarial review, it is subject to immediate judicial review. By the same reasoning, a party that is subject to a notice of proposed debarment could simply wait for the 30-day period for requesting a hearing to pass and then similarly obtain judicial review of the now-final debarment— notwithstanding the fact that the agency's own hearing and decisionmaking procedures have been entirely bypassed.<sup>12</sup> Petitioners' theory, if followed consistently, would permit haphazard review of a variety of preliminary agency decisions that become "final" only because a party has waived its opportunity for administrative review.

If adopted, petitioners' rule would have broad consequences for a large number of common agency practices. Many agency decisionmaking processes are structured like the HUD process at issue in this case. Any administrative process that begins with a proposed agency decision, and provides for that deci-

<sup>12</sup> A party seeking review after having entirely bypassed the agency decisionmaking process may of course have to contend with other obstacles in obtaining judicial reversal of agency action on the basis of arguments not advanced before the agency. See *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33 (1952). In such a case, however, the administrative record could contain preliminary submissions of the party or other materials bringing the party's arguments to the agency's attention. If so, the rule of *United States v. L.A. Tucker Truck Lines* may not prove to be an insuperable obstacle to a determined plaintiff.

sion to become final if there is no objection, would be vulnerable to attack by litigants who deliberately bypass the agency altogether. Similarly, any agency that permits internal review of an initial decision, but provides for the initial decision to become final if no such review is sought, would find its preliminary decisions subject to judicial review whenever a litigant believed that review at that stage would be to the litigant's advantage.<sup>13</sup>

In sum, petitioners' theory would have results that cannot be squared with any reasonable system of judicial review. Under petitioners' theory, plaintiffs would have the greatest incentive to bypass agency appeal procedures in precisely those cases in which

<sup>13</sup> Indeed, Section 8 of the APA, 5 U.S.C. 557, generally provides for a procedure similar to that of HUD, in which the decision of the presiding officer in an on-the-record adjudication under the APA "becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within [the] time provided by rule." Numerous agencies similarly provide by rule. See 13 C.F.R. 134.32 (SBA); 14 C.F.R. Pt. 302 (Dep't of Transportation); 14 C.F.R. 13.233 (FAA); 22 C.F.R. 51.80-51.89 (Dep't of State); 29 C.F.R. 6.20, 6.34, 6.45, 6.5 (Dep't of Labor); 29 C.F.R. 18.58 (Dep't of Labor); 36 C.F.R. 223.138(b) (8) (Forest Service); 40 C.F.R. 32.335, 32.430 (EPA); 47 C.F.R. 1.302 (FCC). Some regulations, however, specify that a failure to invoke internal administrative remedies precludes judicial review. See, e.g., 7 C.F.R. 1.338(m) (Dep't of Agriculture); 8 C.F.R. 336.9(d) (INS); 10 C.F.R. 2.786(b) (1) (NRC); 21 C.F.R. 10.45(b) (FDA). In such cases, traditional exhaustion principles would not govern. Instead, judicial review of any unappealed decision would be precluded, under Section 10(c), regardless of the adequacy of the administrative appeal process, as long as the initial decision was not given operative effect during the pendency of the appeal. Section 10(c), 5 U.S.C. 704.

such appeals would be most useful—*i.e.*, where the initial decision is poorly stated or does not fairly represent agency policy, but where an internal appeal would likely result in a better reasoned adverse decision. The settled doctrine requiring plaintiffs to exhaust administrative remedies guards against those results and promotes a fair and effective system for agency decisionmaking and judicial review. Petitioners' claim that Section 10(c) of the APA was intended to repudiate the exhaustion doctrine should be rejected.

## II. THE COURT OF APPEALS CORRECTLY DETERMINED THAT IT WAS APPROPRIATE TO DENY RELIEF TO PETITIONERS FOR FAILURE TO EXHAUST ADMINISTRATIVE REMEDIES

As set forth, Congress authorized federal courts to continue to recognize traditional "limitations on judicial review," 5 U.S.C. 702, including administrative exhaustion requirements, in the adjudication of APA challenges to agency action. 5 U.S.C. 702. Last term, in *McCarthy v. Madigan*, 112 S.Ct. 1081, 1086 (1992), this Court reiterated the central principles governing the doctrine of administrative exhaustion. First, even where Congress has not expressly required exhaustion, courts have authority to impose an exhaustion requirement in the exercise of "sound judicial discretion." *Ibid.* Second, it remains the "general rule" that exhaustion of administrative remedies should be required in order to serve the "twin purposes of protecting administrative agency authority and promoting judicial efficiency." *Ibid.* Third, a litigant should be relieved from the requirements of this "general rule" only when the "interest of the individual in retaining prompt access to a

federal judicial forum" outweighs the institutional interests advanced by exhaustion. *Id.* at 1087. The court of appeals correctly determined that these settled principles of judicial administration required petitioners to exhaust their administrative remedies before seeking judicial review under the APA.

### A. Exhaustion Of HUD's Administrative Remedies Would Protect Agency Authority And Promote Judicial Efficiency

Under HUD's rules, a hearing officer is authorized to conduct debarment hearings and issue the "initial decision" of the agency. Pet. App. 33a. Thereafter, "[a]ny party" to a debarment proceeding may request discretionary review by the Secretary. 24 C.F.R. 24.314(c). Once a petition for review is filed, the initial decision of the hearing officer is deprived of any operative effect, see 48 Fed. Reg. 43,304 (1983),<sup>14</sup> until the Secretary or his designee either

<sup>14</sup> The cited notice in the Federal Register is an interpretation of HUD's general provisions governing proceedings before a hearing officer, 24 C.F.R. Pt. 26. Those general provisions specify that they apply to debarment proceedings, 24 C.F.R. 26.1, and the debarment regulations specify that secretarial review in debarment proceedings shall proceed in accordance with the provisions of 24 C.F.R. Pt. 26. See 24 C.F.R. 24.314(c). Petitioners assert that "the HUD regulatory scheme subjects a person to administrative sanctions while he contests them before the agency," a fact that in petitioners' view supports their argument that the exhaustion requirement should be excused. Pet. Br. 15-16 n.9; see *id.* at 4 n.5. However, it was the LDP—not the debarment decision itself—that limited HUD's contracting activities during the pendency of administrative proceedings against petitioners. In the court of appeals, petitioners did not challenge the issuance of the LDP as a reasonable means for HUD to protect itself while litigation was pending and, since the LDP had long since

denies review or reaches an independent decision based on the factual record of the initial hearing. 24 C.F.R. 24.314(e). Exhaustion of this administrative appeal process would promote substantial administrative and judicial interests.<sup>15</sup>

1. As this Court explained in *McCarthy*, “[e]xhaustion concerns apply with particular force when the action under review involves exercise of the agency’s discretionary power or when the agency proceedings in question allow the agency to apply its special expertise.” *McCarthy*, 112 S. Ct. at 1086. Both factors are present here.

The decision to debar a contractor is a “discretionary action[,]” see 24 C.F.R. 24.115(a), that must rest primarily with the contracting agency. Debarment decisions are necessarily based upon HUD’s expert assessment of the contractor’s conduct and the agency’s institutional need to prevent further vio-

expired and had no collateral consequences, any such challenge would in any event have been moot. See note 3, *supra*. Moreover, if petitioners’ argument is that the existence of the LDP excuses their failure to exhaust, it proves too much. If the imposition of interim sanctions excuses them from invoking the secretarial review procedure before going to federal court, it would also presumably excuse them from litigating their debarment at all before the agency—including in a hearing before the ALJ—before bringing their complaint to federal court.

<sup>15</sup> Petitioners cite *Levers v. Anderson*, 326 U.S. 219 (1945), for the proposition that a litigant before an agency need not exhaust an administrative remedy that is permissive in nature. As explained above, however, *Levers* involved a permissive petition for rehearing, not an administrative appeal, and the exhaustion doctrine has never been understood to require litigants to request agency rehearing before seeking judicial review. See pp. 22-23, *supra*.

lations of its rules and programs. See 24 C.F.R. 24.115(d) (“The existence of a cause for debarment \* \* \* does not necessarily require that the contractor be debarred; the seriousness of the contractor’s acts or omissions and any mitigating factors should be considered in making any debarment decision.”). The Secretary’s expert assessment of petitioner’s conduct, and the agency’s need to require debarment on the basis of that conduct, could well prove critical to district court review of the debarment orders in this and other cases.

2. Other interests underlying the exhaustion doctrine are also served by the court of appeals’ decision. By bypassing the agency appeal procedure, petitioners deprived the agency of “an opportunity to correct its own mistakes,” *McCarthy*, 112 S. Ct. at 1086, and created the potential for needless burdens on the judicial system. Exhaustion may obviate the need for federal courts to adjudicate issues and controversies—such as this one—that could be fully resolved in further agency proceedings. See *ibid.*; *McKart v. United States*, 395 U.S. 185, 195 (1969).

#### **B. Exhaustion Of HUD Remedies Does Not Impose An Undue Burden On A Litigant’s Right To Obtain Judicial Review Of Debarment Decisions**

According to petitioners, applying the exhaustion doctrine in this case would “transform[] administrative appeals into a gauntlet that must be run before judicial redress can be sought,” and the “attendant costs and delays will deter many persons from seeking judicial review and will devalue any relief ultimately awarded those litigants who do manage to stay the course.” Pet. Br. 19. The remedy provided, however, does not engender extended delays or create procedural traps. It is a fair and effective remedy that

imposes only the most minimal procedural burdens on persons who wish to seek judicial review of debarment orders issued by an ALJ.

1. Contrary to petitioners' contention, the administrative process they bypassed would not have unduly delayed district court review. Under HUD's regulations, petitioners had 15 days to request review by the Secretary. Within 30 days thereafter, the Secretary had to decide whether to grant review, 24 C.F.R. 24.314(c), and, if review was granted, a decision would have been required within 30 days. 24 C.F.R. 24.314(e).<sup>16</sup> Accordingly, exhaustion of petitioners' administrative remedy would have probably taken less than three months. By way of contrast, the district court issued its decision in this case—after several rounds of briefing and arguments by the par-

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<sup>16</sup> Under the regulations, the Secretary does have the authority to extend these deadlines. 24 C.F.R. 24.314(c), 24.314(e). Citing this Court's decision in *Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561, 579-587 (1989), petitioners claimed before the district court and on appeal that the Secretary's right to extend the time periods rendered the administrative process inadequate and thus excused their failure to exhaust it. The district court accepted that argument. See Pet. App. 28a-29a. The court of appeals reversed the district court on that point, observing that petitioners failed to show "that the Secretary has failed, or will fail, to act within a reasonable period of time." Pet. App. 6a. The court also noted that "because [petitioners] did not attempt to exhaust [their] administrative remedies, it is speculative to suggest that the Secretary would have abused his discretion had he been given the opportunity to exercise it." *Ibid.* Before this Court, petitioners do not renew their argument that the administrative remedy was inadequate, and there is no basis for any suggestion that the Secretary would have found it necessary to extend the time periods in this case.

ties—more than one year after the ALJ's Initial Decision and Order and nearly four months after the expiration of the 18-month debarment imposed on petitioners by that order. Pet. App. 14a, 19a, 90a. In this context, the burden of requiring litigants to defer judicial review for two or three months is certainly reasonable. As set forth, the debarment order would not take effect during this period, and the Secretary's action might have obviated the need for any judicial review whatsoever.

2. Petitioners also contend (Pet. Br. 19) that applying the exhaustion doctrine to those in their position would engender procedural confusion. But petitioners' claim that "[i]n many cases it may be unclear or debatable whether there exists an available administrative appeal that was not exhausted," *id.* at 20, is simply not supported by the unambiguous text of the regulations, which inform litigants that they have a right to appeal to the Secretary at the conclusion of the proceedings before the ALJ. 24 C.F.R. 24.314(c).

It is thus not "unclear or debatable" (Pet. Br. 20) whether petitioners failed to exhaust available administrative remedies in this case. As the court of appeals found, petitioners failed to pursue a readily available administrative appeal, whether "by strategic decision or otherwise." Pet. App. 6a. Nor have petitioners offered any support whatever for their supposition that the availability of an administrative remedy poses difficult questions in other factual circumstances.

3. As the court of appeals recognized, Pet. App. 6a, the fact that petitioners' administrative remedy

may no longer be available to them does not excuse their failure to exhaust agency processes.<sup>17</sup> See *McGee v. United States*, 402 U.S. 479, 483 (1971) (holding that a defendant's failure to exhaust administrative remedies deprived him of a defense to a criminal prosecution). Excusing a party's failure to take an administrative appeal on the ground that the time for doing so expired before suit was filed would permit any potential plaintiff to circumvent the exhaustion doctrine at will by defaulting on any opportunity for internal review before filing suit.<sup>18</sup>

In summary, the opportunity for review by the Secretary offered petitioners the potential for a prompt and effective means of obtaining complete relief from the ALJ's debarment order.<sup>19</sup> The Fourth Circuit correctly held that "the facts [of this case] do not warrant application of the exceptions" to the general rule requiring exhaustion. Pet. App. 7a. Accordingly, settled principles limiting judicial re-

<sup>17</sup> It is possible, of course, that the agency would waive the time limits applicable to administrative appeals under appropriate circumstances.

<sup>18</sup> A court could, in the exercise of its judicial discretion, stay judicial review pending completion of administrative proceedings. Because petitioners have never offered any justification for their failure to pursue agency processes, equitable considerations would not have supported that course of action in this case.

<sup>19</sup> As a recent study suggests, HUD provides litigants in debarment cases with more thorough procedural protections, including the opportunity for decision by an independent decisionmaker and administrative appeal, than do most other agencies. See John H. Frye, III, *Survey of Non-ALJ Hearing Programs in the Federal Government*, 44 Admin. L.J. 261, 315, 316 n.200, 317 (1992).

view of agency action barred adjudication of petitioners' claims.

### CONCLUSION

For the foregoing reasons, this Court should affirm the judgment of the court of appeals.

Respectfully submitted.

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## APPENDIX

1. Section 10(a) of the Administrative Procedure Act, 5 U.S.C. 702, provides:

### Right of Review

A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. The United States may be named as a defendant in any such action, and a judgment or decree may be entered against the United States: *Provided*, That any mandatory or injunctive decree shall specify the Federal officer or officers (by name or by title), and their successors in office, personally responsible for compliance. Nothing herein (1) affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground; or (2) confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.

2. Section 10(c) of the Administrative Procedure Act, 5 U.S.C. 704, provides:

**Actions reviewable**

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsiderations, or unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

3. 24 C.F.R. 24.314 provides:

**Determination of hearing officer; review of determination.**

(a) *Written determination.* After the participant or contractor has been afforded an opportunity to be heard, the hearing officer shall make a written determination on the evidence presented, including, where appropriate, any evidence of mitigating circumstances. The hearing officer shall issue a determination in accordance with part 26. If it is proposed that the sanction include an affiliate, the hearing officer shall rule specifically whether, and to what extent, the determination applies to the affiliate. The hearing

officer's determination shall be transmitted to all appealing parties by certified mail, return receipt requested.

(b) *Transmission of determination.* The hearing officer's determination shall also be transmitted promptly to the HUD official who invoked the administrative sanction, and to the Office of General Counsel.

(c) *Finality and Secretarial Review.* The hearing officer's determination shall be final unless, pursuant to 24 CFR part 26, the Secretary or the Secretary's designee, within 30 days of receipt of a request decides as a matter of discretion to review the finding of the hearing officer. The 30 day period for deciding whether to review a determination may be extended upon written notice of such extension by the Secretary or his designee. Any party may request such a review in writing within 15 days of receipt of the hearing officer's determination.

(d) Notice of the Secretary's decision to review the hearing officer's determination and notice of the subsequent determination by the Secretary or the Secretary's designee, shall be given in writing, signed by the Secretary or the Secretary's designee and transmitted by certified mail, return receipt requested.

(e) Where a review is granted, the determination by the Secretary or the Secretary's designee shall be based on the record of the initial hearing and shall fully recite the evidentiary grounds upon which the Secretary's determination is made. Such determination shall be issued within 30 days of the decision to grant review, unless written notice is given by the Secretary

or designee extending the period for making a determination.

(f) Each determination shall become a part of the record.

(g) *Notice of debarring official's decision.* After determination in a contested action, or after the expiration of the period for requesting a hearing when no request has been received, the debarring official shall issue a final determination:

(1) Referring to the notice of proposed debarment;

(2) Specifying the reasons for debarment;

(3) Stating the period of debarment, including effective dates; and

(4) Advising that the debarment is effective for covered transactions throughout the executive branch of the Federal Government unless an agency head or an authorized designee makes the determination referred to in § 24.215.

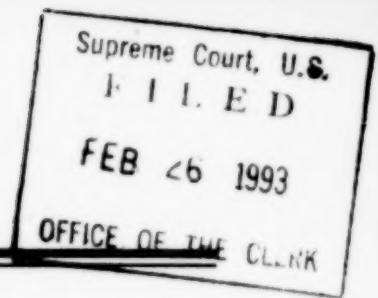
(h) If the debarring official decides not to impose debarment, the respondent shall be given prompt notice of that decision. A decision not to impose debarment shall be without prejudice to a subsequent imposition of debarment by any other agency.

4. 24 C.F.R. 26.25(a) provides:

*Petition for review.* Any party may request review of the hearing officer's determination or order by filing a written petition for review with the Secretary within fifteen days of receipt of

the hearing officer's determination or order. A petition for review may be granted or denied in the discretion of the Secretary or designee. This petition shall not exceed ten pages and shall specifically state the issues and basis upon which the party seeks review. This petition shall be served on all parties and the Secretary simultaneously, in accordance with § 26.15.

No. 91-2045



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IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1992

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R. GORDON DARBY, *et al.*,  
*Petitioners,*  
v.

HENRY G. CISNEROS, *et al.*,  
*Respondents.*

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On Writ of Certiorari to the  
United States Court of Appeals  
for the Fourth Circuit

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**REPLY BRIEF FOR THE PETITIONERS**

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**On Writ of Certiorari to the  
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for the Fourth Circuit**

### REPLY BRIEF FOR THE PETITIONERS

## STATEMENT OF THE CASE

It is uncontested before this Court that the administrative sanctions imposed upon petitioners (hereafter, "Mr. Darby") were unlawful. The district court concluded that "the debarment in this case was not rationally connected to the factual findings of the ALJ, and was further in conflict with the prohibition against imposing debarment for punitive reasons." Pet. App. B at 17a. Although respondents (hereafter, "the government") initially noted an appeal of this ruling, they subsequently abandoned that issue. On appeal to the Fourth Circuit, the government challenged only the district court's refusal to dismiss Mr. Darby's suit on exhaustion grounds. Accordingly, the only issue before this Court is whether Mr. Darby should have been denied the relief to which he was otherwise entitled under the Administrative Proce-

cedure Act ("APA") because of his alleged failure to exhaust administrative remedies. *See Air Courier Conference v. American Postal Workers Union*, 498 U.S. 517, —, 111 S. Ct. 913, 918 (1991).

Nonetheless, the government strives to influence the Court's decision by suggesting that the agency's sanctions were warranted. Its brief details in highly partisan fashion the facts found and conclusions reached by the ALJ in support of the flawed decision to debar Mr. Darby, Resp. Br. 2-7, while ignoring the judicious summary of the district court that is now the law of this case. Indeed, in its zeal to discredit Mr. Darby's actions, the government improperly introduces matters outside the record which have no place before this Court.<sup>1</sup> *Russell v. Southard*, 53 U.S. (12 How.) 139, 158-59 (1851).

### ARGUMENT

#### A. Section 10(c) of the Administrative Procedure Act Codifies the Exhaustion Doctrine for Purposes of Judicial Review Under the Act

The issue presented in this case is whether Mr. Darby can be denied judicial review under the APA of an arbitrary and unlawful administrative sanction because he did not pursue an intra-agency appeal that was not required by statute or agency rule. Mr. Darby contends that the answer is no, and that this issue is controlled by Section 10(c) of the APA, which provides that:

<sup>1</sup> Thus, the government injects in its statement of the case that Lonnie Garvin, the mortgage banker who devised the financing plan which led to Mr. Darby's debarment, "has . . . been debarred twice for violating HUD requirements." Resp. Br. 4 n.2. Not only is this allegation outside the record in this case, but it is misleading as well. The government omits that both of these debarments occurred *after* Mr. Darby's debarment; that the first debarment—presently on appeal to the district court—was based on Mr. Garvin's own use of the financing plan and was a companion to the debarment action against Mr. Darby; and that the second debarment was based on Mr. Garvin's alleged violation of the terms of the first debarment.

Agency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review. A preliminary, procedural, or intermediate agency action or ruling not directly reviewable is subject to review on the review of the final agency action. *Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.*

5 U.S.C. § 704 (emphasis added).

Mr. Darby's position is straightforward: Section 10(c) of the APA codifies the exhaustion doctrine for purposes of judicial review under the APA, and specifies the circumstances under which pursuit of an administrative appeal can be a precondition to judicial review. The statute mandates that an agency's procedural ground rules be spelled out in advance for all to see. It freely permits either the agency (by appropriate rule) or Congress (by statute) to require exhaustion of intra-agency appeals. However, absent the imposition of such a requirement, the statute entitles a litigant aggrieved by a final agency decision to seek judicial relief without first exhausting theoretically available, but non-mandatory, administrative remedies.

Unable to refute this argument on the merits, the government resorts to misstating Mr. Darby's position so that it can attack an argument which Mr. Darby has never made. Thus, the government repeatedly and erroneously claims that Mr. Darby is arguing that Section 10(c) eradicates the exhaustion doctrine with respect to actions under the APA. *See* Resp. Br. 13 ("Petitioners' assertions that Section 10(c) . . . rendered the exhaustion doctrine inapplicable in any action for judicial review

under the APA is mistaken.”); *id.* at 16 (“[P]etitioners’ claim that the exhaustion doctrine no longer applies in APA actions . . . .”); *id.* at 18 (“The core premise of petitioners’ theory is that Section 10(c) repudiated the exhaustion doctrine . . . .”). Quite to the contrary—and as the government well knows—Mr. Darby contends that Section 10(c) *codified* the exhaustion doctrine for purposes of judicial review under the APA.

The government denies that Section 10(c) even deals with exhaustion of administrative remedies, and argues that it addresses only the distinct (although related) issue of finality. *See* Resp. Br. 10, 15, 22. This remarkable contention is contradicted by the statutory language, the relevant legislative history, and this Court’s decisions.

There is no question that the first two sentences of Section 10(c) address the issue of finality as a prerequisite to judicial review of administrative action. Accordingly, this Court has cited Section 10(c) repeatedly with respect to the finality requirement. *See, e.g., Franklin v. Massachusetts*, — U.S. —, —, 112 S. Ct. 2767, 2773 (1992); *Lujan v. National Wildlife Fed’n*, 497 U.S. 871, 882 (1990); *FTC v. Standard Oil Co.*, 449 U.S. 232 (1980); *CAB v. Delta Air Lines*, 367 U.S. 316, 327 n.9 (1961).

However, the third and last sentence of Section 10(c) unmistakably addresses the issue of exhaustion. It provides that:

Except as otherwise expressly required by statute, agency action otherwise final is final for the purposes of this section whether or not there has been presented or determined an application for a declaratory order, for any form of reconsideration, or, unless the agency otherwise requires by rule and provides that the action meanwhile is inoperative, for an appeal to superior agency authority.

The government makes the facile argument that “[Section 10(c)] contains no reference to the term ‘exhaus-

tion,’ and provides only that agency action must be final to be ‘subject to judicial review.’” Resp. Br. 10. This contention cannot withstand analysis. If the only purpose of Section 10(c) was to establish the requirement of finality, then the third sentence of the provision would be superfluous and inexplicable. In fact, the third sentence presupposes the existence of a *final* agency action and proceeds to address whether there are any additional *procedural* prerequisites to judicial review. This is the essence of exhaustion, not finality.

While the policies underlying the two concepts often overlap, the finality requirement is concerned with whether the initial decision-maker has arrived at a definitive position on the issue that inflicts an actual, concrete injury; the exhaustion requirement generally refers to administrative and judicial procedures by which an injured party may seek review of an adverse decision and obtain a remedy if the decision is found to be unlawful or otherwise inappropriate.

*Williamson County Regional Planning Comm’n v. Hamilton Bank*, 473 U.S. 172, 193 (1985).

The legislative history of Section 10(c) confirms that the third sentence of the provision addresses the issue of exhaustion. When Congress was considering the enactment of the APA, the Department of Justice advised it that:

The last sentence [of Section 10(c)] makes it clear that the doctrine of exhaustion of administrative remedies with respect to finality of agency action is intended to be applicable only (1) where expressly required by statute (as, for example, is provided in 49 U.S.C. 17(9)), or (2) where the agency’s rules require that decisions by subordinate officers must be appealed to superior agency authority before the decision may be regarded as final for purposes of judicial review.

S. Rep. No. 752, 79th Cong., 1st Sess. 44 (1945), reprinted in Senate Judiciary Comm., 79th Cong., 2d Sess., *Administrative Procedure Act: Legislative History* 185, 230 (Comm. Print 1946) ("APA Leg. Hist.").<sup>2</sup> The government now seeks to disavow its own contemporaneous construction of Section 10(c).

Moreover, the Court itself has recognized explicitly that "the primary thrust of § [10(c)] was to codify the exhaustion requirement." *Bowen v. Massachusetts*, 487 U.S. 879, 903 (1988). The government conspicuously ignores this decision in arguing to the contrary.

**B. The 1976 Amendment to Section 10(a) of the Administrative Procedure Act Which Eliminated the Defense of Sovereign Immunity Has No Bearing Whatsoever on Exhaustion of Administrative Remedies**

The government next contends that the 1976 amendment to Section 10(a) of the APA, 5 U.S.C. § 702, which eliminated the defense of sovereign immunity, somehow refutes Mr. Darby's construction of Section 10(c). Resp. Br. 16-18. This argument is a red herring.

The purpose of the 1976 amendment was to remove the defense of sovereign immunity as a bar to judicial review of administrative action under the APA. In order to underscore the limited scope of the amendment, Congress

<sup>2</sup> A commentator who reviewed the legislative history of Section 10(c) after the enactment of the APA reached the same conclusion about its import with respect to the issue of exhaustion.

As originally introduced 10(c) said nothing as to whether an administrative appeal was a condition precedent to judicial review. In the final draft it was provided that an administrative appeal would not be necessary to exhaust administrative remedies unless the board adopted a rule that during the pendency of the appeal the effectiveness of the order would be automatically stayed. This was when the substitution occurred. Compare the original draft, SEN. Doc. No. 248, 79th Cong., 2d Sess. 160 (1946), with the final draft. *Id.* at 8.

Comment, "Final" Orders: Section 10(c) of the APA, 6 Stan. L. Rev. 531, 535 n.29 (1954).

included the following provisos in the revised statutory language:

Nothing herein (1) affects other limitations on judicial review or the power or duty of the court to dismiss any action or deny relief on any other appropriate legal or equitable ground; or (2) confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.

5 U.S.C. § 702. In the accompanying legislative history, Congress listed failure to exhaust administrative remedies as one of a number of independent limitations on judicial review that would remain unchanged by the amendment. See H.R. Rep. No. 1656, 94th Cong., 2d Sess. 9-10, 12 (1976), reprinted in 1976 U.S.C.C.A.N. 6121, 6130, 6132; S. Rep. No. 996, 94th Cong., 2d Sess. 9, 11 (1976).

The government argues that "Congress's express recognition of the continuing vitality of the exhaustion doctrine in 1976—and its enactment of statutory language recognizing that courts may continue to apply such traditional doctrines in APA cases—is fundamentally at odds with petitioners' construction of Section 10(c)." Resp. Br. 18. However, there are two fallacies in this argument. First, contrary to the government's claim, Mr. Darby does not contend that Congress repudiated the exhaustion doctrine in Section 10(c). Thus, the "continuing vitality" of the exhaustion doctrine in APA cases is fully consistent with Mr. Darby's construction of Section 10(c).

Furthermore, while Congress provided that limitations on judicial review other than sovereign immunity were unaffected by the 1976 amendment to Section 10(a), it did not purport to address the substance of those limitations. To the contrary, Congress emphasized that the 1976 legislation had no bearing on those other limitations, including failure to exhaust administrative remedies. It is impossible to glean any guidance from the amendment

or from its administrative history about how exhaustion requirements are to be derived or applied in APA actions.<sup>3</sup>

**C. Federal Courts Cannot Impose Exhaustion Requirements in Derogation of Section 10(c)**

The government implicitly concedes that Mr. Darby fulfilled all of the preconditions to judicial review set forth by Congress in Section 10(c). Nonetheless, it maintains that the federal courts have a reservoir of authority to postulate additional exhaustion requirements on an *ad hoc* basis and to deprive litigants of judicial review because of their failure to satisfy these judicially-created conditions. Thus, the government asserts:

Section 10(c) does not *preclude* review of petitioners' claim. But nor does it *require* review under circumstances where courts would traditionally impose an exhaustion requirement in the interests of administrative and judicial efficiency.

Resp. Br. 10 (emphasis in original); *see also id.* at 15-16.

This tortured construction of Section 10(c) would render the statute a congressional exercise in futility by leaving the courts free to deprive a litigant of judicial review notwithstanding the explicit provisions of the statute. Indeed, the government's construction would stand Section 10(c) on its head and would transform it from a provision which removes obstacles to judicial review, *see Bowen v. Massachusetts*, 487 U.S. at 904, into a trap for unwary litigants who assume that the statute

<sup>3</sup> Moreover, any opinion Congress might have expressed in 1976 about the meaning of Section 10(c) would provide an extremely hazardous basis for construing a statute that was enacted thirty years earlier. *See, e.g., Wright v. West*, — U.S. —, — n.9, 112 S. Ct. 2482, 2492 n.9 (1992). “[S]ubsequent legislative history will rarely override a reasonable interpretation of a statute that can be gleaned from its language and legislative history prior to its enactment.” *Consumer Product Safety Comm’n v. GTE Sylvania, Inc.*, 447 U.S. 102, 118 n.13 (1980).

means what it says. Neither logic nor the law supports this unjust result.

As a matter of logic, the government's construction of Section 10(c) is nonsensical. Why would Congress have bothered to enact the last sentence of the statute if exhaustion issues in APA cases still were to be decided by the courts on an *ad hoc* basis and, moreover, if the courts were free to disregard or even negate the statutory provisions? Why would Congress have commanded agencies to spell out their exhaustion requirements in advance while simultaneously permitting them to sandbag litigants with unforeseen exhaustion defenses in court? The answer, of course, is that Congress never would have engaged in such an exercise. This explains why the government clings to the untenable position that Congress did not address the issue of exhaustion in Section 10(c). Once it is acknowledged that the statute does address exhaustion, then the government's argument that courts remain free to impose additional exhaustion requirements in APA actions crumbles.

As a matter of law, the government's argument ignores the constitutional imperative that federal courts “have no more right to decline the exercise of jurisdiction which is given, than to usurp that which is not given.” *McCarthy v. Madigan*, — U.S. —, —, 112 S. Ct. 1081, 1087 (1992) (citing *Cohens v. Virginia*, 19 U.S. (6 Wheat.), 264, 404 (1821)). The APA explicitly provides, in Section 10(a), that “[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is *entitled* to judicial review thereof.” 5 U.S.C. § 702 (emphasis added). Accordingly, this Court has stated that

Any person ‘adversely affected or aggrieved’ by agency action, *see* § 702, . . . is entitled to ‘judicial review thereof,’ as long as the action is a ‘final agency action for which there is no other adequate remedy in a court,’ *see* § 704.

*Heckler v. Chaney*, 470 U.S. 821, 828 (1985); see also *Webster v. Doe*, 486 U.S. 592, 599 (1988).<sup>4</sup>

Furthermore, the government's position is flawed as a matter of statutory construction. Engaging in a selective reading of the legislative history of Section 10(c), the government makes much of several comments that the provision was intended to state existing law. The government then leaps from this premise to the conclusion that "it is highly unlikely that Section 10(c) was intended to deprive courts of their traditional authority to require exhaustion of administrative remedies (including appeals) when the needs of administrative autonomy and judicial efficiency outweigh private interests in early access to a judicial forum." Resp. Br. 20. However, this argument is nothing more than an exercise in bootstrapping.

The government fails to acknowledge that, while the provisions of Section 10(c) indeed were consistent with existing law,<sup>5</sup> Congress plainly intended that the statutory provisions henceforth would govern exhaustion issues to the exclusion of any conflicting authority. This is made abundantly clear by considering the full text of Attorney General Clark's commentary about Section 10(c).

<sup>4</sup> Contrary to the government's assertion, it is not Mr. Darby's theory that "Section 10(c) mandates immediate judicial review of all final agency decisions." Resp. Br. 25. Mr. Darby contends that Section 10(c) governs the issue of exhaustion—i.e. whether a litigant may be denied judicial review because of an alleged procedural default on his/her part. Mr. Darby does not contend that Section 10(c) resolves distinct issues such as ripeness. As discussed more fully below, the construction of Section 10(c) propounded by Mr. Darby here is fully consistent with this Court's ripeness jurisprudence, including the Court's decision in *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158 (1967).

<sup>5</sup> See *Levers v. Anderson*, 326 U.S. 219 (1945); *Banton v. Belt Line Ry.*, 268 U.S. 413, 416-17 (1925); *United States v. Abilene & S. Ry.*, 265 U.S. 274, 280-82 (1924); *Prendergast v. New York Tel. Co.*, 262 U.S. 43, 48 (1923).

Section 10(c): This subsection states (subject to the provisions of section 10(a)) the acts which are reviewable under section 10. *It is intended to state existing law.* The last sentence makes it clear that *the doctrine of exhaustion of administrative remedies with respect to finality of agency action is intended to be applicable only (1) where expressly required by statute (as, for example, is provided in 49 U.S.C. 17(9)), or (2) where the agency's rules require that decisions by subordinate officers must be appealed to superior agency authority before the decision may be regarded as final for purposes of judicial review.*

S. Rep. No. 752, 79th Cong., 1st Sess. 44 (1945), reprinted in APA Leg. Hist. at 230 (emphasis added). Thus, contrary to the government's suggestion, there is every reason to believe that exhaustion requirements are to be applied "only" in conformance with Section 10(c) and that the courts have no residual authority to impose additional exhaustion requirements.

This conclusion is reinforced by a functional analysis of Section 10(c). The statute explicitly provides for judicial review of final agency actions if there is no mandatory administrative appeal process. Further, it ordains that the administrative appeals are mandatory for exhaustion purposes only if they are required by statute or agency regulation. The statute provides that, for purposes of judicial review under the APA, exhaustion requirements can be established only by Congress or by the agencies; only in advance; and only through rules of general applicability. The "rule of judicial administration" promulgated by the Fourth Circuit in this case is the antithesis of Section 10(c) on all these counts.

This Court recently confronted a similar issue in *Astoria Federal Savings & Loan Ass'n v. Solimino*, — U.S. —, 111 S. Ct. 2166 (1991). The question presented in that case was whether federal courts should grant preclusive effect to state administrative findings with

respect to age-discrimination claims. The Court explained the crux of that issue as follows:

Courts do not, of course, have free rein to impose rules of preclusion, as a matter of policy, when the interpretation of a statute is at hand. In this context, the question is not whether administrative estoppel is wise but whether it is intended by the legislature.

— U.S. at —; 111 S. Ct. at 2169. After analyzing the provisions of the Age Act, the Court concluded that they carried an implication against preclusion which overrode any common-law rule that would otherwise apply.

— U.S. at —; 111 S. Ct. at 2171. Likewise, Section 10(c) implicitly displaces the common law exhaustion doctrine with respect to actions under the APA.

#### **D. This Court's Decisions Do Not Support the Government's Construction of Section 10(c)**

The government contends that Mr. Darby is "mistaken" in relying upon this Court's statement, in *ICC v. Brotherhood of Locomotive Engineers*, 482 U.S. 270, 284-85 (1987), that Section 10(c) relieves parties from the requirement of petitioning an agency for rehearing before seeking judicial review. The government attempts to distinguish that decision on the grounds that it involved a petition for reconsideration, as opposed to an intra-agency appeal. Resp. Br. 23. This purported distinction is refuted by the language of Section 10(c), itself, which articulates an exhaustion rule equally applicable to "an appeal to superior agency authority" and to petitions "for any form of reconsideration."

Likewise, the government seeks to distinguish the Court's decision in *Levers v. Anderson*, 326 U.S. 219 (1945) because it involved a motion for rehearing, rather than an appeal to higher authority. Yet the government cannot gainsay that this decision held that a litigant need not exhaust an administrative remedy that is permissive in nature.

Striving vainly to come up with some countervailing authority, the government cites the decisions in *FTC v. Standard Oil Co.*, 449 U.S. 232 (1980) and *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158 (1967). Resp. Br. 21-22. However, the government's reliance on these cases is completely misplaced.

*Standard Oil* did not purport to explore the contours of the exhaustion doctrine; rather, it addressed the need for finality as the threshold requirement for judicial review of agency action. In that regard, the Court noted that a litigant's exhaustion of available administrative remedies does not necessarily render an agency's action final. This holding underscores that it is the finality requirement, not the exhaustion doctrine, which provides the primary assurance against premature judicial review of agency decisionmaking. *Standard Oil* does not bar judicial review here since the finality of the contested agency actions is undisputed.

*Toilet Goods* also is inapposite since that case dealt with the distinct issue of ripeness, not exhaustion. The distinction between the two doctrines is subtle, but vital.

The ripeness doctrine . . . has a different focus and a different basis from exhaustion. The exhaustion doctrine emphasizes the position of the party seeking review; in essence, it asks whether he may be attempting to short circuit the administrative process or whether he has been reasonably diligent in protecting his own interests. Ripeness, by contrast, is concerned primarily with the institutional relationships between courts and agencies, and the competence of the courts to resolve disputes without further administrative refinement of the issues.

Ernest Gellhorn & Barry B. Boyer, *Administrative Law and Process* 318-19 (2d ed. 1981).

In *Toilet Goods*, the Court concluded that the litigants should be required to "exhaust" an additional administrative process *not* because there had been any procedural

default by the litigants, but rather to ripen the issues and thereby facilitate subsequent judicial review. 387 U.S. at 166. In contrast, the issue presented in this case is exhaustion, not ripeness. There is no question that the challenged agency actions were ripe for judicial review; the only issue is whether Mr. Darby satisfied the procedural preconditions to review. As noted above, Mr. Darby contends that Section 10(c) disposes of the exhaustion issue presented here, but he does not contend that Section 10(c) governs ripeness issues. There is no conflict between *Toilet Goods* and the construction of Section 10(c) which Mr. Darby propounds.

As a last resort, the government makes a futile attempt to analogize this case to decisions of this Court involving the doctrine of primary jurisdiction, the abstention doctrine, and claims arising on Indian reservations. Resp. Br. 25-27. The doctrine of primary jurisdiction is akin to the ripeness doctrine in that it defers judicial review pending administrative resolution of certain issues, not because of a procedural default by the litigant but because of the agency's special competence. See, e.g., *Nader v. Allegheny Airlines, Inc.*, 426 U.S. 290 (1976). That doctrine is inapposite here for the same reason as is the ripeness doctrine. The government's other analogies do not involve judicial review of federal administrative action, and seek to compare apples to oranges insofar as the concept of "exhaustion" is concerned.

#### **E. Mr. Darby's Construction of Section 10(c) Would Not Disrupt Orderly Judicial Review of Agency Action**

The government contends unpersuasively that Mr. Darby's construction of Section 10(c) would enable litigants to bypass their administrative remedies altogether. Resp. Br. 28-29. However, judicial review under the APA is limited to the administrative record made before the agency, not some new record made in the reviewing court. See *Florida Power & Light Co. v. Lorion*, 470 U.S. 729, 743-44 (1985). Moreover, it is a long-settled

rule that courts reviewing agency action will not entertain arguments which were not raised before the agency. See *United States v. L.A. Tucker Truck Lines*, 344 U.S. 33 (1952). The government is forced to concede that this latter rule would preclude most attempts to bypass agency processes. Nonetheless, it speculates that the rule may not be an "insuperable obstacle" if a party filled the administrative record with "preliminary submissions . . . or other materials bringing the party's arguments to the agency's attention." Resp. Br. 28 n.12. But, the government never explains how a party could create such an administrative record without participating in the agency's process, and its speculations are unfounded.

The foregoing limitations, together with the doctrines of finality, ripeness, and primary jurisdiction, provide federal courts with ample safeguards to prevent persons from short-circuiting administrative processes before seeking judicial relief. The courts need not resort to the creation of exhaustion requirements that clash with the provisions of Section 10(c) and that deprive litigants of judicial review promised to them by Congress.

The government's further complaint with Mr. Darby's construction of Section 10(c) would permit haphazard review of a variety of preliminary agency decisions cannot be taken seriously. The obvious remedy is for agencies to amend their rules to require exhaustion of administrative appeals in conformance with Section 10(c), *not* for federal courts to impose judicial exhaustion requirements in contravention of Section 10(c).

#### **F. The Fourth Circuit's Decision Violates Section 10(c) and Settled Principles of Exhaustion**

In conclusion, the government argues that "settled principles limiting judicial review of agency action barred adjudication of [Mr. Darby's] claims." Resp. Br. 36-37. The truth is exactly the opposite. It has long been settled that litigants need not exhaust permissive administrative

remedies before seeking judicial review. See *Prendergast v. New York Tel. Co.*, 262 U.S. at 48; *Levers v. Anderson*, 326 U.S. 219 (1945). It is also settled that application of the judicially-created exhaustion doctrine is committed to the sound discretion of the trial court. *NLRB v. Industrial Union of Marine & Shipbuilding Workers*, 391 U.S. 418, 426 n.8 (1968). The district court, after careful consideration, found three distinct reasons not to dismiss Mr. Darby's action on exhaustion grounds. In closely analogous circumstances, this Court found no abuse of discretion when a district court proceeded to review an agency's decision. *United States v. Abilene & S. Ry.*, 265 U.S. at 280-82. Accordingly, the Fourth Circuit's decision to reverse the district court and deprive Mr. Darby of any judicial recourse is insupportable under "settled principles" of exhaustion, even without regard to Section 10(c) of the APA.

Section 10(c), however, cannot be disregarded since it codifies the exhaustion doctrine—and controls the resolution of exhaustion issues—with respect to APA actions in federal courts. The statute's insistence that exhaustion requirements be spelled out in advance for all to see is sound policy and fully consonant with Congress's purpose—to remove obstacles to judicial review of agency actions. See *Bowen v. Massachusetts*, 487 U.S. at 904. Moreover, it is the law of the land. The Fourth Circuit's decision conflicts with the express will of Congress as articulated in Section 10(c) and effectively nullifies that statute. It derogates from the obligation of federal courts to exercise the jurisdiction which Congress has given them, and, in the case of the APA, to protect citizens such as Mr. Darby from unlawful and abusive agency actions.

## CONCLUSION

The judgment of the court of appeals should be reversed and the judgment of the district court, granting relief to Mr. Darby, should be affirmed.

Respectfully submitted,

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